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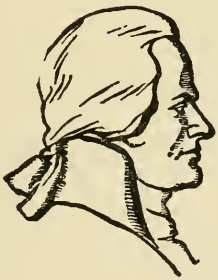

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Modern Business

EDITOR-IN-CHIEF

JOSEPH FRENCH JOHNSON

Dean, New York University School of
Commerce, Accounts and Finance

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ROLAND P. FALKNER

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LEO GREENDLINGER, CHARLES W. HURD

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CREDIT
AND THE CREDIT MAN

BY

THE EDITORS

IN COLLABORATION WITH

DWIGHT E. BEEBE, CHARLES W. GERSTENBERG
WALTER S. JOHNSON AND PETER P. WAHLSTAD

MODERN BUSINESS
VOLUME 8

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PREFACE

The part that credit plays in the general organization of modern life is portrayed in the Text in "Economics of Business." In the present volume credit appears as a phase of business management. It is the purpose of the Text to show the general principles which underlie the granting of credit as well as the business organization in its various aspects, which has made possible the conduct of business on a large scale upon the basis of credit.

It is recognized that only one-half the story is told when credit is granted, that it is not complete till the promised money has been collected. Collections indeed are so intimate a part of credit operations that they cannot be severed from it except by a crude mental surgery. They occupy, therefore, a considerable space in the present treatment.

In the preparation of this Text, the editors have drawn upon many sources of information and experience. Mr. Wahlstad's consideration of credit, Mr. Beebe's discussion of collections, and the exposition of the law of credit protection and of bankruptcy in the United States by Mr. Gerstenberg and in Canada by Mr. Johnson, form the framework upon which the treatment has been built up. But the mention of these collaborators does not exhaust the list of those

whose suggestion, counsel and experience have been woven into the fabric. Special thanks are due to Mr. Alexander Wall of the National Bank of Commerce of Detroit and Mr. George P. Woodruff of the Alexander Hamilton Institute.

THE EDITORS.

TABLE OF CONTENTS

CHAPTER I

MERCANTILE CREDIT

SECTION		PAGE
1.	Growth of Credit in Modern Business	1
2.	Meaning of Credit	2
3.	General and Individual Aspects of Credit	2
4.	Increasing the Working Power of Capital	4
5.	Excessive Credit a Danger	5
6.	How Credit Helps the Manufacturer	6
7.	Main Points to Determine Credit	8
8.	Methods of Granting Credit	9
9.	Credit Affected by General Trade Conditions	10
10.	Turns of the Business Cycle	10
11.	Place of the Credit Man in the Business	12

CHAPTER II

BOOK CREDIT

1.	Development of Book Credit	14
2.	Nature of the Open Book Account	15
3.	The Open Book Account—Economic Objections	16
4.	The Book Account—Ethical Objections	19
5.	Taking Unearned Discounts	21
6.	Charging Interest on Deferred Payments	22
7.	Realizing upon Open Book Accounts	23
8.	Methods of Assigning Accounts	25
9.	Registration of Assigned Accounts	26
10.	Where Book Accounts are Advantageous	26

CHAPTER III

DOCUMENTARY CREDIT

SECTION		PAGE
1.	The Forms of Documentary Credit	31
2.	The Promissory Note	32
3.	Indorsement	34
4.	Tangible Evidence of Indebtedness	35
5.	Action on Notes	36
6.	Drafts	36
7.	Notes, Drafts and Acceptances	37
8.	Nature and Form of the Trade Acceptance	38
9.	Summary of Advantages to the Seller	41
10.	Advantages to the Buyer	44
11.	The Bank and the Trade Acceptance	47
12.	What is a Commercial Transaction?	49
13.	Preserving the Discount	51
14.	Other Trade Acceptance Features	52
15.	Handling Accounts when Acceptance is not Paid	53
16.	Retailers and the Trade Acceptance	54
17.	Introducing the Trade Acceptance	55
18.	Future of Trade Acceptance	57

CHAPTER IV

GRANTING CREDIT—PERSONAL CONSIDERATIONS

1.	What Limits Credit	58
2.	Personal Credit	58
3.	Deciding When to Grant Personal Credit	59
4.	Moral Character in its Relation to Credit	60
5.	The Good Moral Risk	61
6.	Mercantile Credit	63
7.	Business Ability, Native and Acquired	64
8.	Technical Ability	65
9.	Knowledge and Experience	66
10.	Buying Methods	66
11.	Judgment	68

SECTION PAGE
12. Equipment 69
13. Advertising 70
14. Location 70
15. Age 71
16. Evidence of Financial Ability 72
17. Outside Ventures 74
18. Distribution of Due Dates 74
19. Cooperation with Mercantile Agencies . . . 75
20. Insurance 75
21. Payment Methods 76
22. Financial Strength 76
23. Capital—How Acquired 77
24. The Customer Who Makes Unjust Claims . . 78

CHAPTER V

GRANTING CREDIT—BUSINESS CONSIDERATIONS

1. Importance of Business Methods 80
2. How Credit is Affected 81
3. Differences in Turnover 82
4. Amount of Credit Affected by Turnover . . . 84
5. Duration of Credit 85
6. A Study of Business Types 86
7. Customary Credit Terms in the Grocery Business 87
8. Customary Credit Terms in the Hardware Business 89
9. Customary Credit Practice in the Boot and Shoe Business 91
10. Men's and Boys' Suits 93
11. Customary Credit Terms in the Lumber Business 94
12. Customary Credit Terms in the Furniture Business 95

CHAPTER VI

SOURCES OF CREDIT INFORMATION

1. Importance of Complete Information . . . 97
2. Over-Estimating the Value of References . . 98

SECTION PAGE
3. Five Important Sources of Credit Information . 98
4. Property Statement: a Basic Consideration . . 99
5. Growing Importance of the Property Statement . 100
6. Periodical Revision of Signed Statements . . 101
7. Common Forms of Property Statements . . . 103
8. Mercantile Agency Service 104
9. Dun's and Bradstreet's Rating Books . . . 108
10. Special Credit Reports 109
11. Cost of the Agency Service 110
12. Special Trade Agencies 110
13. Salesman as a Credit Reporter 111
14. Traveling Credit Man 114
15. Local Attorney as Credit Reporter 116
16. Law Lists and Free Attorney Reports . . . 118
17. Banks as Sources of Credit Information . . . 122

CHAPTER VII

COOPERATIVE METHODS IN CREDIT INVESTIGATION

1. Credit Cooperative Methods 125
2. Characteristics of Ledger Experience 126
3. Procedure in the Exchange of Ledger Information. 128
4. Reciprocity a Necessary Element 129
5. Operating thru a Central Bureau 129
6. Credit Clearing 131
7. Inherent Defects of Credit Clearing 132
8. The Credit Clearing House 134
9. The Percentage System 134
10. Giving Credit Advice 136
11. A System Based on Abnormal Transactions . . 137
12. Growing Recognition of Credit Interchange . . 138
13. A Probable Credit Interchange System of the Future 139
14. The National Association of Credit Men . . . 141

SECTION PAGE
15. Association Ethics 143
16. Retail Credit Men's National Association . . 144

CHAPTER VIII

ANALYSIS OF CREDIT INFORMATION

1. The Financial Statement; Merchandise on Hand . 145
2. Notes and Accounts 146
3. Cash on Hand or in Bank 147
4. Fixtures, Machinery, etc. 148
5. Owing for Merchandise on Open Account . . 148
6. Owing to Banks and to Relatives 148
7. Outside Assets 148
8. Convertibility of Assets 149
9. Can More Definite Rules be Given? 151
10. Business Types 151
11. Typical Statements 152
12. Varying Considerations 153
13. The Effect on Credit Information 154
14. Analysis of Agency Reports 154
15. Report on a Manufacturing Firm 155
16. Analysis 156
17. Advance Report and Salesmen's Data . . . 158
18. Analysis 160

CHAPTER IX

THE CREDIT MAN

1. Credit Man's Place in the Scheme of Business . 165
2. The Question of Authority 167
3. Attitude Toward the Customer 168
4. Mental Qualities Desirable in a Credit Man . . 170
5. Moral and Social Qualities 172
6. Special Training 173
7. The Credit Man as a Business Force 176

SECTION PAGE
8. A "Business Service" Department 178
9. Direct Value of Cooperation with Customer . . 179

CHAPTER X

CREDIT MANAGEMENT

1. Essentials of Organization 182
2. Functions of the Department 183
3. Requesting a Signed Statement 185
4. Handling New Orders 186
5. Discrimination in Credit-Granting 187
6. Understanding as to Terms 188
7. Holding the Order Pending Investigation . . . 189
8. Final Disposition of the Order 190
9. Departmental Organization Problems 191
10. Standardizing the Departmental Routine . . . 192
11. Departmental Reports 192

CHAPTER XI

COLLECTING THE MONEY DUE

1. Determining the Collection Policy 194
2. Putting the Policy to Work 195
3. Need for a General House Policy on Collections . 196
4. Making Collections "Constructive" 197
5. Building Good-Will Thru Collection Methods . . 197
6. What is to be Learned from Complaints . . . 199
7. Classification of Debtors 200
8. Good Pay 201
9. Slow Pay or on "Probation" 202
10. Delinquent or Bad Pays 203
11. Execution Proof 203
12. Planning the System to Carry Out the Policy . 205
13. Effect of Trade Usage on Collection Policy . . 207

CHAPTER XII

THE COLLECTION MANAGER AND HIS WORK

SECTION		PAGE
1.	Personal Characteristics	209
2.	Relations of Collection to Credit Department	212
3.	Making Use of Credit Office Machinery to Assure Collection Results	214
4.	Organization of Collection Department	215
5.	Responsibility	216
6.	Training for the Work—Special and General	217

CHAPTER XIII

PRINCIPLES UNDERLYING COLLECTION EFFORT

1.	The Debtor's Motives	220
2.	The Right Mental Attitude	222
3.	The Personality Back of the Appeal	223
4.	Value of Repetition	225
5.	Need for Salesmanship in Collecting	227
6.	Utilizing the Power of Habit	228
7.	Appeals to the Emotions	229
8.	Knowledge of the Debtor Essential	230

CHAPTER XIV

COLLECTING ON A FRIENDLY BASIS

1.	Advantage and Obligation	232
2.	Need for Getting at the Causes of Non-Payment	232
3.	Stages in Collection Procedure	233
4.	Notification Stage	233
5.	Reminder Stage	234
6.	Offer of Concession	235
7.	Discounting Notes	235
8.	Reproach Stage	236
9.	Acceptance Drafts	237
10.	Sight Drafts	238
11.	Follow-Up Drafts	238

SECTION PAGE
12. Telephone Calls 239
13. Registered Letters 240
14. Telegram 241
15. Discussion Stage 242
16. Defective Remittances 243
17. Writing to the Debtor's Business Acquaintances . 244
18. Tracing Moved Debtors 245
19. Tracing Thru National Association of Credit Men 246
20. Tracing Thru the Post Office 247
21. Reselling Stage 248

CHAPTER XV

UNFRIENDLY STAGES OF COLLECTION

1. Advisibility of Going to Last Extreme in Collecting 251
2. Final Stages of Collection Procedure . . . 252
3. Black Lists 252
4. Offering Debtors' Accounts for Sale 253
5. House Collection Agency 253
6. Final Notice Before Suit 255
7. Utilizing the Bad Check Laws 255
8. Selecting an Attorney 257
9. Using Attorneys in Other Cities 260
10. Using a Third Party to "Forward" Claims . . 265
11. Using Collection Agencies 268
12. How the Agency Works 269
13. Cooperating with the Attorney or Agency . . 270

CHAPTER XVI

CREDIT PROTECTION

1. Methods of Securing Protection 273
2. Credit Insurance 274
3. Arguments in Favor of Credit Insurance . . . 276
4. Arguments Against Credit Insurance 277
5. Adjustment Bureaus 278

SECTION PAGE
6. Means of Recovery 280
7. Unpaid Seller's Lien 280
8. *Stoppage in Transitu* 281
9. Reselling the Goods 282
10. Recovery on the Ground of Fraud 283
11. Steps in Litigation 283
12. Importance of Evidence 284
13. Enforcing the Judgment 285
14. Exemptions 285
15. Supplementary Proceedings 286
16. Setting Aside Fraudulent Conveyances . . . 286
17. Bulk Sales Law 287
18. Receivers 287
19. Garnishment 288
20. Attachment 288
21. Imprisonment for Debt 289
22. The Criminal Law as a Remedy 290
23. Shall We Go to Law? 291

CHAPTER XVII

BANKRUPTCY

1. Meaning of Bankruptcy 292
2. Meaning of Insolvency 292
3. Bankruptcy and Insolvency Laws 293
4. State and Federal Laws 294
5. Two Kinds of Bankruptcy 294
6. Contents of the Petition 295
7. Acts of Bankruptcy 295
8. The Five Acts of Bankruptcy 296
9. Provisional Remedies Pending Adjudication . . 297
10. Trial and Reference of Proceedings to Referee . 298
11. Meetings of Creditors 299
12. Trustees in Bankruptcy 299
13. Duties of Bankrupt 300

SECTION PAGE
14. Schedules 300
15. Valid, Provable and Allowable Claims 301
16. Valid Claims 301
17. Provable Claims 302
18. Allowable Claims 303
19. Voidable Preferences 304
20. Priority of Debts in Distribution of Bankrupt's Estate 305
21. Dividends in Bankruptcy 305
22. Composition with Creditors 306
23. Discharge of Bankrupt 307
24. Debts Not Discharged in Bankruptcy 307
25. Advantages of Bankruptcy Act 308
26. Canadian Practice 309
27. Procedure 309
28. Fraudulent Conveyances and Transfers . . . 310
29. Fraud by Insolvent Traders 311
30. Winding Up of Companies 312
31. Insolvency of a Company: Law Determined . . 313
32. Duties of Liquidator 314
33. All Claims May Be Proved 314
34. Bulk Sales 315

CHAPTER XVIII

THE ROLE OF THE CREDIT DEPARTMENT IN DEVELOPING BUSINESS

1. Relation of Collection to Sales Department . . 316
2. Every Salesman an Assistant Credit Man . . . 317
3. Credit Man as a Salesman 319
4. The Nerve Center of the Business 320
5. The Credit Man as a Service Man 321
6. Viewing the House Advertising from the Credit Angle 322
7. Bringing Dead Accounts to Life 322
8. Need for a Broad Credit Policy 323

CREDIT AND THE CREDIT MAN

CHAPTER I

MERCANTILE CREDIT

1. *Growth of credit in modern business.*—At the outbreak of the European War in 1914 numerous predictions were made that the struggle must of necessity be a short one thru sheer inability of the nations to carry the terrific financial burden for any length of time. The same reasoning would have had every nation bankrupt before two years had elapsed—yet the finish found the great nations still solvent, carrying financial burdens of a magnitude previously unheard of. If it had been necessary to finance the war thru cash payments, predictions of early bankruptcy would have been more than justified. The same machinery of credit, however, that permits the development and expansion of business enterprises into the millions of dollars has permitted national financing in terms of billions. Thru the entire growth of business and industry, credit has gradually been assuming a more and more important place

as a means of settling business transactions. This development has now reached the point where all but a small fraction of the world's business is transacted with credit as the means of exchange, altho the transactions are measured in terms of money. Thru credit the transfer of funds to cover every individual transaction is obviated, the volume of business is greatly increased and the extent of operation both by buyer and seller greatly enlarged.

2. *Meaning of credit.*—When credit is extended one person or business house buys goods or renders services in return for a promise to pay for these goods or services at some future time. Credit, then, is an exchange of goods or services for a future promise to pay. It is this latter element of the transaction that comes up for examination whenever credit is extended. What is the value of this promise to pay? Is it fortified by such reasonable assurances that a man may safely sell his goods or render his services without receiving the actual cash at the time of the exchange?

3. *General and individual aspects of credit.*—The place which credit occupies in the economic world has been discussed in the Modern Business text on "Economics of Business." The burden of the discussion there is what credit does for the world at large, how it has made possible the development of production and wealth. In thus considering credit it appears somewhat as an abstraction remote from the affairs of the individual. Again it is some of the broader

aspects of credit which will find consideration in the text on "Banking."

The purpose of the present treatment is to consider credit as a phase of business management. It is more concrete, more definite, more intimately related to the business problems of the individual whether he is concerned with the question of granting credits or whether as an applicant for credit he seeks to validate his request. It will not be the credit applicant, however, but the credit giver who occupies the center of the stage.

The problem which will engage our attention is how the manufacturer or the merchant decides whether or not a given applicant is to receive the credit he asks. This is a vital question in the conduct of business since injudicious credit granting may wreck an enterprise. We have to examine, then, the principles according to which a decision is reached and the safeguards which business practice has erected to insure a wise decision.

The discussion of credit, therefore, will not be abstract and general, but will concern its concrete and individual application. It is neither the general economic aspects of credit, nor the purely personal phases of the question which will occupy us, but the business side of credit—in short, mercantile credit—with which we shall have to concern ourselves.

The granting of credit in the business world whether by manufacturers, merchants or banking institutions is determined by a consideration of the

merit of the applicant and by a regard for general business conditions. It is especially to the elements which enter into the merit of the applicant, the means taken by the credit giver to discover precisely what it is, as well as the procedure of granting credit, and making the collections which necessarily follow it that the present treatment is devoted.

4. *Increasing the working power of capital.*— Credit, by reason of its suitability as a medium of exchange, makes it possible for commercial transactions to be carried on with much greater ease and freedom than when settlements are required in goods or money. Another and equally beneficial service rendered by credit is that it permits the merchant to increase the working power of his capital. With a capital of $10,000 he might readily be able by means of credit to do as large a business as if he owned $20,000 in his own right.

It is evident that when a manufacturer or wholesaler places a quantity of his goods in a retail dealer's hands he virtually gives him the use of his capital to that extent for the period of the credit term, whether this be one of thirty, sixty or ninety days. To the retail merchant this means much more than the value of money as measured by the usual interest rate. In other words, if money may be borrowed from the bank at an annual interest rate of, say, five per cent, the value of the credit which the merchant obtains from the wholesaler is normally much greater. For, as already pointed out, by means of such credit

the former makes a merchandising profit upon the capital employed—generally more than double the amount of the banking rate of interest.

5. *Excessive credit a danger.*—We must not conclude, however, from the foregoing that by increasing his credit indefinitely the merchant also necessarily increases his profits. Credit in his case, in order to be beneficial, must bear a fixed relation to the volume of business permitted by local conditions. If, for example, the character of the business, the neighborhood in which the store is located, or other causes restrict the possible volume of business to a certain amount, it is evident that no additional amount of credit extended to that dealer will make it possible for him to sell more goods. If used beyond a certain point, credit, instead of remaining a friend and helper, may become not only a useless burden, but a foe and at times even a destroyer. Unless the merchant possess sufficient business capacity to determine in advance, and with reasonable accuracy, the total volume of his annual sales, and unless he is able to proportion that volume rightly among his various departments, he is in danger of being misled by alluring offers of credit and as a result may overstock himself with goods which for the time being, at least, he will be unable to sell.

This condition results in the tying up of capital and credit where they are unable to serve him, thereby diminishing his active resources in an equal amount and placing additional burdens upon the re-

mainder of his capital. Frequently these burdens become too heavy for their weakened support, so that when accounts mature and payments are demanded, sufficient funds are not at hand to meet them. A state of delinquency is the result. Presently, unless in some way the burden is lifted, the delinquency spreads to accounts with other creditors, and before long a state of insolvency is induced, compelling creditors for their own protection to step in and demand an adjustment of the dealer's affairs, either with or without his consent and cooperation. For this reason overbuying, by which is understood buying in excess of the actual demands of his trade, is one of the greatest dangers to which the average retail merchant is exposed. Against this danger every properly conducted wholesale and manufacturing concern is constantly on the watch.

Where, on the other hand, the dealer's situation is one in which a larger volume of business could be done provided additional capital were available for purposes of increasing stocks of salable merchandise, the employment of additional credit is not only in itself perfectly legitimate but also distinctly profitable to both dealer and supply house.

6. *How credit helps the manufacturer.*—Another instance of the benefits of credit for purposes of business extension is where a manufacturer has sold his output of goods to wholesalers or jobbers on usual credit terms of, say, sixty days, and where this output represents practically all the manufacturer's avail-

able capital—a condition not uncommon among small manufacturers. Under the circumstances, if he had to pay cash he would not be able either to buy the necessary raw material or to enlarge his factory in order to take care of an expected increase in orders. He might not in fact be able to continue the production of additional goods until the goods sold had been paid for. At the same time he could not well afford to let his plant be shut down or his men remain idle for sixty days while he waited for his customers to settle their accounts. He would need the use of his money at once.

Thru the good offices of credit the manufacturer is able to repossess himself of his capital without any delay. The bank, which is primarily an institution for the purchase and sale of credit, stands ready to buy, with certain safeguards, the manufacturer's right to demand payment from his customers in sixty days. In payment for this right the bank in turn gives the manufacturer a right to use its—the bank's—credit in an equal amount, less the interest charge for the intervening period. The bank may, of course, if requested to do so, pay to the manufacturer the amount in gold. Usually, however, it merely credits the amount on its books to the manufacturer's account. But for the manufacturer's purpose the bank's credit, which he thus obtains, is just as useful as the gold which it represents, since with the aid of that credit he may at once resume his productive activities, buy raw material and pay his workmen's wages, exactly as

tho his customers had paid him cash for their purchases.

7. *Main points to determine credit.*—Credit has been defined as an exchange of goods or service for a promise to pay in the future. It is evident that the main consideration of the credit man is devoted to determining the worth of the promise. The buyer must conform to certain standards—his business must be able to endure certain tests. He is to receive goods upon his promise. A sale upon a promise that does not come up to these standards is not granting of credit at all. It is simply bad business. The possession of written promises to pay can never take the place of a thoro and adequate determination of the worth of the debtor's promise for, after all, a note or an acceptance, in its legal effect, is only the buyer's verbal promise reduced to writing. The written instrument as such is not security. And regardless of the means by which the transaction has been effected, should the buyer's promise be bad, the seller is left in the position of having parted with his goods in exchange for something which may be worthless, and which in any event he will be put to much trouble to realize upon.

In simple form the three questions that the seller asks himself about the prospective buyer are: Is he honest? Has he business ability? Has he sufficient resources? These questions go to the root of the matter of determining a buyer's credit.

In addition to three elements of character, business

ability and capital indicated, a fourth measure of consideration might be added and that is the form of the buyer's enterprise. If the buyer is a corporation, the assets actually owned by it are the only ones to which the creditor may look in case it becomes necessary to force the debt at law. Similarly, the stockholders are not partners in the enterprise and are not likely to aid it with their personal resources in case of any unforeseen trouble. An individual or partnership, however, is fortified not only by its own capital but by the private fortune of the individual or the members of the firm. The unlimited personal liability of the individuals and partners for the debts of the business enterprise they are conducting is a strong incentive to them to employ every means looking toward the success of the business. If the business gets into serious difficulty, the private estate of the individual partner is endangered. Given equality between a partnership and a corporation in regard to the three major factors already indicated, the former is entitled to a greater measure of credit than the latter because of the personal liability of its various members.

8. *Methods of granting credit.*—Credit is always granted upon the promise of the buyer. That promise may either be implied as in the case where a customer "charges" a purchase at his retail grocer or it may be expressed, that is, evidenced by a written instrument. The written promise may take the form either of a promissory note or a trade acceptance or

draft. In the note the buyer gives the seller his written promise to pay within a specified time. In the trade acceptance or draft, the seller draws an order on the buyer for the amount of the sale and when this draft or trade acceptance is "accepted" the buyer agrees to fulfill the order. The buyer's acceptance is in effect his promissory note.

9. *Credit affected by general trade conditions.*—The prime factors that influence the granting of credit and the amount that will be extended have been already indicated. These are the factors that are individual and rest entirely upon the condition of the business of the credit seeker. So closely interwoven is the modern fabric of business, however, that general conditions, whether of prosperity or depression, have a vital influence at all times upon the extent to which credit may be granted. It is as true of money and credit as of any commodity that when it is plentiful prices fall and it is comparatively easy to obtain. Conversely, when money becomes scarce, merchants cannot obtain it so easily or under such favorable terms. The result is that merchants cannot tie up so large a proportion of their goods in credit transactions as they could in times when money was more easily obtainable. The volume of general credit has contracted and in the same way the individual business houses' buying power is curtailed.

10. *Turns of the business cycle.*—Over any extended period of years it will be seen that there have been times of great prosperity and periods of reaction

or "hard times." Mercantile credit is concerned with this swing of the business cycle or at least it ought to be. During a period of prosperity all business is riding at the top of the tide. Railroad earnings are large, building operations are being carried on extensively, bank clearings show a great increase and the volume of the deposits shows a considerable growth. During such a time, with prosperity everywhere, credit is widely asked for and granted freely. Stimulated by the "boom," manufacturer, wholesaler and retailer add to their stock, relying on the rise of prices for greater and greater profit. Such a condition causes larger buying on credit since each class is out to reap its full share of the prosperity.

In turn, when with plants working at capacity, the various markets become glutted, there being a superabundance of goods, prices commence to fall. The same scramble that ensued when prices were rising now takes place, only with a different purpose. Where before dealers were anxious to purchase largely in order to turn large profits, now they are anxious to sell at once in order to save themselves against too heavy losses. It is in times such as this that business houses which have made purchases of stocks on wide margins of credit often find that falling prices will net them not the profit they had anticipated, but an actual loss.

The problem of the credit man is not merely trailing with the times, granting credit freely when it is asked freely and contracting when business in general

contracts, but it is anticipating these times. In a period when all is optimism and business is apparently swinging indefinitely upward in a rush of prosperity the far-sighted credit man will, by studying external factors, prove his worth to his house by anticipating just how near the crest of the wave of prosperity the business craft has risen. The credit man who can hold his buyers to reasonable margins before the ebb sets in and who does not find himself with a great burden of accounts receivable in a time of depression is a valuable executive. He combines the acumen and the skill of his own work with the ingenuity and foresight of the banker.

11. *Place of the credit man in the business.*—The credit man himself can never lose sight of the fact that he is performing only one function of the business enterprise—that he is not standing alone. The most important work of a business is selling, but it is equally important that it make a profit from its sales. Laxness on the part of the credit man may result in a loss of profit thru permitting bad accounts to get on the books. Too great a degree of strictness may cost the firm customers who are good credit risks altho they may not be of the highest. The credit man has to steer a middle course. Cooperation is as important a part of his duties as standing guard. A credit man whose company had a number of travelling men on the road found that he was not gaining any great popularity with the salesmen due to the fact that every now and then he was compelled to turn down

orders from houses that the salesmen had sold. Aside from the injury to his personal popularity it struck him as a duplication of effort for a salesman first to sell a customer and then for the credit man to turn the customer down. The solution was soon found. Thereafter a plan was worked out whereby the credit man was notified in advance of the territory into which the different men on the road were going. He was then able to go over the entire field of houses in that particular line in the territory and tell the salesmen in advance who were the good credit risks and those to whom credit should not be offered. This credit man became a sales builder thru providing the salesmen in advance with a select list of customers.

Not only must the credit man be able to cooperate with other departments, and be a student of trade and business in his ability to foresee changes in the general business conditions, but thru it all he must be a diplomat. He has it within his power to drive old customers away or to educate the recalcitrant customer so as to earn his everlasting good-will. It is with these various phases of the credit man's activities that the body of this work will deal.

REVIEW

Why is it ordinarily more profitable for a merchant to do business on part borrowed capital than on capital all his own?

At what point in the development of a business will the use of additional credit prove excessive, hence unprofitable, and eventually injurious?

What are the considerations to be kept in mind by the seller in determining what credit to extend?

CHAPTER II

BOOK CREDIT

1. *Development of book credit.*—Probably the most familiar method of selling goods on credit is by what is known as "book credit." Here the goods pass into the hands of the buyer after his credit title has been passed upon and the seller bills him for the amount of the invoice at the terms which were agreed upon at the time of sale. The term "book credit" is used because the sole tangible evidence of the transaction is that which is contained in the seller's books of original entry. While book credit is widely known, it has had its growth during the past sixty years. Previous to that time the bulk of sales were made on bills of exchange, the prototype of the trade acceptance of today.

The growth of book credit has some historical interest. All of our legal, commercial and social customs were carried over from the mother country at the time of the separation in 1776. The acceptance has long been the most familiar credit instrument in England and on the European Continent, and up to the time of the Civil War it enjoyed a steady growth in this country. The conflict between the States brought in its train unsettled credit conditions and

high interest rates. Ready money was hard to obtain. A condition of this sort naturally fostered the offering of inducements to buyers to make settlement in cash. With high money rates the seller was no longer willing to wait for the buyer to meet the usual acceptance or draft. He needed the money immediately and this resulted in the birth of the cash discount. It was of more importance to the buyer to obtain the money immediately even at the cost of offering a considerable discount from the gross quotation rather than to wait. The practice of carrying buyers on open book accounts grew steadily and even today the open book account with the cash discount privilege forms the major part of our credit transactions. Improved communication facilities, the development of the railroads, telegraph and telephone also served to bring buyer and seller into close touch with one another. The improvement in banking accommodations also played a prominent part in the growth of selling on open book account. With commercial banks in practically every community, the buyer was able to borrow from the bank at the prevailing interest rate and take advantage of the heavy discount terms offered.

2. *Nature of the open book account.*—When a sale is made on an open book account, there is an implied promise to pay on the part of the buyer. This promise may be fortified by letters if there has been correspondence regarding the sale and such correspondence can be put together so as to piece out a

contract. On the whole, however, the seller's books of original entry are the only evidence of the transaction. The open book account sale, then, is a sort of "gentleman's agreement." The buyer obtains the goods and in return the seller has the implied promise of the buyer to pay for them. Such a "gentlemen's agreement" is all right—if the buyer is a gentleman. Complications necessarily arise tho if he is not, or if he is prevented from acting like one by circumstances outside of his control. Here the seller has only his own books to rely upon. If it is ever necessary to go into court to collect the bill, the buyer may assert that the goods were not received, that they were damaged all or in part, or that the terms of sale were different from those which the seller asserts. The buyer may assert that the goods were sent him on a consignment sale (only those goods which were sold to be paid for) or he may set up a counter-claim, alleging that some other transaction was to offset the amount of the seller's bill in whole or in part. By its very nature the open book account leaves all the advantage with the buyer. He has the goods, and the seller has only his implied promise to pay for them.

3. *The open book account—economic objections.*—Such a system has its obvious faults. Many of them have been recognized clearly for some time. If an analysis of this method of selling were attempted it would be possible to group the objections to the open book account as economic and ethical. Under the

head of economic objections are the facts that on open accounts (1) the seller is compelled to act as a banker for the buyer; (2) the capital value of the merchandise remains buried in the goods for the life of the credit term; and (3) the lack of a sharply defined time for the payment of accounts has been a fruitful source of business failure thru the tendency to over-buy and the correlative tendency to over-sell.

If Smith sells goods to Brown on 60-days' time he is acting as Brown's banker. Of course, Brown does not get an actual loan of money but he obtains the loan of capital represented in the goods. It may be pointed out that Smith can go to the bank, discount his own notes and finance himself. He can do this, of course, but he still remains Brown's banker, for the note he discounts at his bank is one for which he has to pledge his general credit. The capital he has in the goods remains buried in them until Brown pays his bill. It has been well said that "An outstanding account represents money tied up which cannot work."

Capital is tied up in another way thru the large ratio asked by banks for a loan. If it becomes necessary for a seller to pledge his accounts receivable with a banker or broker, he will have even more capital tied up. The great objection of over-buying and over-selling is no less important to the general business of the country than the tying up of his capital is to the individual seller. In sales on open book account it is understood that payment is to be made

in a specified time. There is no written instrument to evidence that fact, however, and this, in itself, produces laxity. If the buyer is unable to pay promptly in sixty days, he may run on for a fortnight or a month more without getting into trouble. On the other hand, if Brown knows that he has a definite obligation to meet at a certain time, he will not allow his buying eyes to become greater than his selling stomach. If he has the feeling that he can meet his obligations practically at his will, there is no tangible check to his enthusiasm for new goods shown him. The same indefiniteness that encourages over-buying is also a tendency to over-sell. When a man loans another money on a note, his first thought is, "Can this man pay his note when it falls due?" The same consideration is found in the sale of real estate where a mortgage is taken as part of the purchase money. In sales on the tangible open book, however, the thought is apt to loom up consciously in the mind of the salesman, "Well, if he can't meet the whole bill at the time it is rendered, he can at least pay something on account." The same thought running in the mind of five salesmen for different wholesalers is an encouragement to all of them to sell the buyer as much as he is willing to take and to trust to good fortune that he will not become a delinquent.

It might be said that the seller can avoid acting as the buyer's banker if the buyer takes advantage of the cash discount. This is true, but the seller pays a high price for it. If Smith has to give Brown two

per cent of his bill to induce Brown to pay it within ten days' time, he is paying a far higher rate of interest than he would pay anywhere else for the use of money, and in this case the money for the use of which he is paying is really his own.

4. *The book account—ethical objections.*—Among the criticisms that can be levelled at the book account from the ethical standpoint is the fact that the cash discount gives the large dealer an advantage over the small one and the door for litigation is left wide open, inasmuch as the seller has only his book account as evidence of the transactions, the state in which the goods were received and the integrity of the shipment.

The cash discount is undoubtedly an aid to the big dealer. A man doing a business of $500,000 may be carrying on his enterprise on no stronger lines than a man doing a business of $25,000. The economic condition of both enterprises may be exactly the same. The big dealer, however, commands better credit facilities. Then, just as the credit term is often taken advantage of thru the buyer taking a much longer time for payment, the discount privilege may be abused. The actual time for the taking of a discount may have elapsed but if the seller is greatly in need of cash, he will be apt to permit the buyer to take advantage of the cash discount in order to obtain the funds which he needs. In short, the open book account is a two-edged sword in the hands of the buyer. Having both the seller's goods and his own money, he enjoys all of those intangible nine points

of the law that go with possession. The seller, of course, has ample remedies to enforce his claim. But goods are not sold with litigation in view as a means of collecting on them. A single sale means nothing to a business house. What it is trying to do is to build up a list of customers who will be steady buyers and for this very reason, the selling house can ill afford to take measures that will alienate the goodwill of individual buyers, even when the action of the buyer reduces them to a point of exasperation.

The buyer's over-buying may even be deliberate. This may, of course, be done with deliberate fraudulent intent, but this is not the sort of over-buying that is the greatest danger to the credit man. For the deliberate fraud will usually not pass the tests of character, ability and capital that will be put to him and so not be in a position to obtain goods with intent to defraud the seller. The dangerous kind of overbuying is apt to come from houses whose credit has already been established but which find themselves slipping into precarious financial difficulties. How is over-buying going to help such a house? Suppose a concern finds that its capital is running short and that in the future it may have to curtail its operations to a considerable extent in order to get along. Anticipating difficulties in the future, the buyer lays in heavy stocks of goods. The anticipated difficulties come and the buyer is short of working capital. The burden, however, falls upon those who have sold him. The company must raise money, obtain extensions

from creditors or go under. With the prospect of the buyer going into insolvency and the conseqent shrinkage of accounts to a fraction of their worth on the dollar, the creditor is practically compelled to extend the time for payment of accounts. Accordingly, under the open book account method of trading, the buyer may of his own will, and with deliberate intent, place the creditor in a position where he must extend the time of payment indefinitely, or see his receivables shrink as the buyer goes thru the slow and costly processes of bankruptcy.

5. *Taking unearned discounts.*—Many a dealer who never would take a five-cent piece belonging to another, appears to have no conscientious scruples about taking a cash discount to which he is not entitled, and frequently regards it as little less than an insult to be reminded by the wholesaler that the terms of sale are to be observed according to the letter.

Let us suppose the terms of sale to stipulate a cash discount of two per cent for making payment within ten days—which is a custom that obtains in many lines of business. The purpose of such a discount is, of course, to induce an immediate payment. Obviously, it is most unfair for a debtor to deduct the cash discount when he does not make payment until after the ten days have elapsed; yet this is just what is being done by many, and it is causing much annoyance and actual loss to the creditors. Fifteen, twenty, and even thirty days are taken by some customers who nevertheless invariably deduct the cash

discount before remitting the amount of their bills.

Not a few wholesale houses, for fear of losing the dealer's trade, submit to this form of exploitation without protest; others, tho they may make mild protests concerning the irregularity of the practice, fail to take a positive stand in the matter. Some, and their number is happily growing larger each year, decline to submit to what they regard as a dishonest practice, and invariably charge the dealer with any sum, however small, that has been unjustly deducted in the form of a cash discount. The latter course, in addition to being the only right one from a moral standpoint, has the advantage of inculcating in the debtors' minds a wholesome respect for the house that pursues it, and a corresponding confidence in its goods and service. It is the practically unanimous testimony of those who have put themselves on record as absolutely opposed to the abuse of discount terms, that this attitude has caused the loss of no desirable customer. Moreover, it is found that a frank and courteous statement of the attitude of the house in the matter of the observance of discount terms is usually sufficient to convince any dealer who is in the least degree fair-minded, that the practice complained of is wholly without justification in equity and morals.

6. *Charging interest on deferred payments.*—The same line of reasoning that condemns the deduction of unearned cash discounts insists upon the payment of interest on every past-due account. Yet in many instances the obvious justice of this stand is ignored

by buyer and seller alike. Accounts that are sold "net thirty days," are frequently not paid until forty-five or sixty days have elapsed—at times not even then.

The wholesale house that consents to have payment deferred in this manner, is virtually lending its capital to the delinquent debtor without any compensation whatever. Since the debtor, if he were to borrow the money at the bank, would have to pay interest upon the loan, there appears to be no good reason why the wholesaler's capital should not be entitled to equal earnings while in the debtor's possession beyond the regular credit period. As a matter of fact, the wholesaler is really entitled to more than the usual five or six per cent per annum, since under ordinary circumstances he could earn more than that by employing the money in his business.

As with the custom of taking unearned cash discounts, so also the matter of paying interest on past-due accounts is largely a question of right attitude on the part of the creditor. Experience shows that the evils complained of can be removed whenever a correct policy is adopted and consistently maintained. The exercise of a little tact will often go far toward making a customer, who has been guilty of such practices, see the evil of his ways and change for the better.

7. *Realizing upon open book accounts.*—Where sales are made on open book account, the time may come when the seller will face the necessity of raising

money upon his floating assets. With the growth of the book account system, means for borrowing upon accounts outstanding came into being. A first essential is that the borrower be well known to the banker, for as there is no tangible evidence of the buyer's obligations, except the books of the seller, the banker who loans money upon the account must necessarily do so largely upon the seller's credit.

As soon as it became evident that the practice of lending upon book accounts was safe and profitable if conducted with due care, a regular system for dealing in credits of this kind grew up. While at first this business was handled by the banks as part of their loan department routine, it eventually came to be the work of a special department organized for that purpose. However, many of the banks found that business of this kind, being highly specialized, was not always profitable, especially in view of the conservatism that is always necessary in the conduct of a bank. Gradually the function of the bank was taken over by a type of brokerage institution that made a specialty of handling business paper. The brokers soon became experts in judging credit and the brokerage concerns, as they gained in capital strength and in prestige, came to be looked upon as valuable adjuncts to the banking system. Thus, where a bank finds itself unable to assume the risk of discounting book accounts at first hand, it is frequently able to lend money on the security which the broker furnishes.

8. *Methods of assigning accounts.*—The exact methods by which this business is handled vary to some extent. Sometimes the merchant who assigns his accounts may draw against the amount of such accounts up to a certain point—say 75 per cent.

The terms upon which the assignment may be made are of course largely determined by the nature of the accounts and by the standing of the assignor himself. Often the merchant is made the agent of the assignee, collecting the individual accounts as they fall due and using the money in his own business. It goes without saying, however, that in this case the merchant is under the necessity of replacing the collected accounts with new ones in order always to maintain a proper balance. The chief advantage of this method to the merchant is that it permits him to hide from his customers the fact that he has assigned his accounts. If the bank commission house is willing to assume all risks and buy the accounts outright, the terms are, of course, less favorable to the assignor. Usually the accounts are bought only at a heavy discount.

But while the assignment of his accounts is a perfectly legitimate feature, the merchant who finds it necessary to resort to this expedient in order to meet his current liabilities is not always regarded in the best light by his creditors, if the matter becomes known to them. Not only does this procedure indicate that the merchant is urgently in need of funds, but the assignment of his accounts receivable, unless

illegally made, withdraws them from his assets and diminishes by that amount the resources available for distribution among creditors in case of failure in business.

9. *Registration of assigned accounts.*—One phase of this practice has repeatedly come up for discussion and has received rather a severe criticism. That is the element of secrecy in the selling and pledging of accounts. It is pointed out that such a system lends itself readily to the practice of fraud, not only upon creditors, but upon the finance companies that advance money on such pledges. Cases have occurred in which it was found, after the failure of the debtor, that all accounts receivable had been hypothecated. It has been known that in some cases instalment leases have been duplicated by fraudulent dealers and that bogus shipments have been recorded for the purpose of defrauding the financial house to which the accounts were sold. This raises the question whether, in order to prevent fraud, all sales and purchases of accounts should not be made matters of public record just as in the case of chattel mortgages. The fairness and justice of this suggestion is evident and there has been some agitation looking toward the enactment of legislation to insure against possible fraud upon creditors.

10. *Where book accounts are advantageous.*—While every objection that has been noted against the book account as a method of selling on credit is valid, it is not to be universally condemned. There are

many cases where it is not only the most convenient but the best means of handling and recording credit sales. One of these is obviously the retailer.

Altho some attempts have been made to introduce the trade acceptance into different forms of retail activity, on the whole the open book account is the best method for handling sales to individual customers. In the case of department stores, grocers, dealers in staples such as meat and milk and other retailers, the individual sales are of such frequency and in such small amounts that any method other than the open book account would flood the business machinery of the retailer and introduce an unneeded inconvenience to the consumer. In the case of the large department store, its credit machinery is, or should be, ample to guard it against getting many accounts on its books that are unsound or that are likely to prove slow pay. Some proportion of such accounts is, of course, unavoidable, but with houses selling in small amounts and at frequent intervals to individual buyers, the chief concern is building up a clientele of persons who patronize the place both for the excellence of its goods and for the facilities which are offered for their purchase. Where the individual accounts are small, too, the customer who takes too long a time for payment or who acts in other ways to embarrass the selling house, cannot cause so great a degree of embarrassment as to affect vitally the house's financial condition.

Aside from the retailer there are other lines where

the open book account is more satisfactory than sales on credit documents. Some of these classes of business may be outlined as follows:

A. *Where the capital represented by merchandise sold is not large.*—There are some lines of business where the actual physical goods sold form only a small part of the contract that the selling house enters into. The gist of the contract may lie largely in the services which the seller is going to render. In the case of a business selling only goods, a book account sale means loaning so much of its capital goods for the credit period. If this feature is not present, one objection to the use of the book account is removed and if some other considerations are not present, there is no logical objection to sales by this means of credit.

B. *"Non-repeaters."*—Some lines of business are engaged in selling a product which is of such a nature that once the buyer has taken it, he is supplied for an indefinite time and there is no likelihood of his being again a prospect for the same product. In such a line of business, the question of the buyer's ability to take the product can arise only once. Since this is the case, the judgment of the credit man must always be the fundamental factor in extending credit and the use of a trade acceptance or any other credit instrument would not serve to cut down the proportion of bad or delinquent accounts.

C. *Contract sales.*—It has been seen that the open book account may give rise to disputes between buyer and seller that can only be settled thru litigation. In

many lines, however, while the buyer's written acceptance or note is not taken, the sale is made upon a written contract. Such a contract embodies within itself all of the terms and conditions of the sale, since a written contract is not subject to variation by verbal evidence. So far as "sewing up" the buyer is concerned, then, a written contract is as effective a means as any other. The case of the carpenter or plumber who makes repairs for the landlord is an instance. When such a contract is reduced to writing, the contractor has an instrument that precludes the raising of any questions except that of the quality of the work.

D. *Specialties.*—In some lines there may be diplomatic reasons for preserving the book account even tho otherwise it is not desirable. Such a line is that of a specialty where a high-class body of salesmen must not only sell the buyer but educate him frequently to the point where the sale is possible. Here is another phase of the credit's man cooperation with the sales department. Any system of granting credit that would interfere with the effectiveness of the men in the field thru making it necessary not only to sell the buyer on the worth of the product but to sell him on the means of paying for the product constitutes a handicap that should not be imposed on the salesman.

REVIEW

From the credit grantor's standpoint wherein does the practice of selling on open book account put him to a disadvantage?

How are open book accounts used for the purpose of raising money?

What commercial abuses have grown out of the present practice of doing business on open account?

What safeguards are taken to prevent the practice of frauds in assignment of accounts?

What are the advantages of the open account system?

CHAPTER III

DOCUMENTARY CREDIT

1. *The forms of documentary credit.*—In the preceding chapter, it has been brought out that in a sale on a book account, there is an implied promise on the part of the buyer to pay for the goods sold. This chapter will deal with forms of sales on credit where the promise of the buyer is not implied but is expressed thru the medium of a written instrument. Such a written instrument may either be a promissory note made by the buyer, or a draft or trade acceptance drawn by the seller. Points of similarity between each of these forms of written obligation will be noted. It is to be borne in mind thruout the discussion, however, that a note or acceptance is nothing more than a written promise to pay. It does not, like a mortgage, set aside any part of the debtor's goods as security for the payment.

Since the note or trade acceptance is only a written promise to pay, it is to be emphasized again that the chief consideration is always the intrinsic worth of the buyer's promise. Like a sale on a book account, the promise is good in proportion to the willingness, ability and worth of the debtor. A bad written promise is no better than a bad verbal promise. The written

obligations of the debtor, however, have certain manifold advantages to the seller that are coming to be recognized as of very great importance. Consideration will be given to the legal effect of such instruments and to their economic effect—the manner in which the two-edged sword which the buyer holds over the seller in the case of an open book account is thus deprived of one of its edges.

2. *The promissory note.*—A promissory note is nothing more than the written promise of the buyer to pay the seller the amount of the bill at a certain specified time. A common form of note is as follows:

\$200 Cincinnati, Ohio, Jan. 8, 1919.

Thirty days after date I promise to pay to the order of H. R. Smith & Company Two Hundred Dollars at the First National Bank of Cincinnati. Value received.

WILLIAM H. JONES.

There are certain essentials which a good promissory note must possess. In the first place, it must contain an absolute promise. In this connection, an acknowledgment that a debt is due is a very different thing from a promissory note. An "I.O.U." is an admission that a debt is owed, but it is not a promise to pay it. Similarly, such phrasing as "Owe H. R. Smith two hundred dollars, value received," does not, of itself, help create a new instrument whereby the person signing it agrees to pay such a debt. The first consideration to be looked to in a note, then, is whether the promise to pay is absolute and unconditional. If it merely reflects and acknowledges the

justness of an obligation already incurred, it is not a promissory note.

The question may sometimes arise as to whether or not a note is unconditional. A note made payable "two months after goods are sold" would not be good. The goods might never be sold by the buyer. In the same way notes made payable a certain time after the arrival of a ship in port would not be negotiable for the same reason. The same indefiniteness may arise when a note is made payable out of certain funds. If the buyer promises to pay out of funds realized from the sale of certain goods, or out of the proceeds received from certain other business in which he is engaged, his note is again open to question for there may be no proceeds out of the sources indicated. Not only must there be a promise, but the promise must be unconditional. One class of notes has come up for some question in the courts, namely, where notes are given for instalment payments but the condition is made that in the event of failure to meet any instalment, the entire series of notes will thereupon become due and payable. The validity and negotiability of notes of this class have been established by the courts and such a provision in instalment notes does not affect in any way their validity.

Just as the promise must be certain and unconditional, the person to whom the note is payable must be indicated clearly and the amount of money to be paid must be certain. A promise to pay in goods is not a good negotiable instrument, for the value of

the goods may fluctuate. A proviso that a note is to be paid with interest or at the current exchange, however, does not affect its negotiability, since both of these are elements that may readily be determined and measured in terms of money.

3. *Indorsement.*—It may sometimes happen that the note is indorsed by some person other than the buyer. Such a practice is not usual in commercial transactions and usually it would only occur when it was necessary to fortify the buyer's credit with that of some other more responsible party. When such an indorsement is given, the indorser lends his name and credit to the maker of the note. The effect of such an accommodation indorsement may be briefly referred to. It is a general rule that consideration is essential to a valid contract. Where a person lends his name on a note and receives no consideration, it may be asked how he can be held liable if the maker of the note fails to meet it. This is worked out thru the doctrine of estoppel. Once a man has placed his name on a negotiable instrument that may pass into the hands of innocent third parties, he is absolutely liable to make good the promise of the maker of the note whether the third parties have knowledge of the fact that he is only an accommodation indorser or not. He has made the promise of the debtor his own promise. Having done this, the courts will hold that he is precluded from setting up as a defense on the note the fact that it was not his own obligation and that he received no consideration for lending his name.

An accommodation indorsement means full responsibility to any subsequent holder of the note.

4. *Tangible evidence of indebtedness.*—The note, being a written promise of the buyer, is a tangible evidence of his indebtedness. This evidence being contained in a single instrument, that instrument is negotiable (that is, it may pass from hand to hand) in much the same manner that a note put out by a bank in one town passes from hand to hand among the people in widely scattered parts of the country. The difference is that whereas the bank note passes from hand to hand merely by delivery, the note of an individual passes by indorsement.

Once in possession of a note, the seller has an instrument that he may negotiate. By placing his indorsement upon it, he may discount it at the bank or he may transfer it to other parties who are willing to accept it in lieu of cash. Such third parties are those who are acquainted with the credit and responsibility of the maker. While the note is not used to any considerable extent in mercantile transactions, it has a definite value to the seller when it is obtained either in the usual course of trade or in the course of some unusual transaction. Since it may be negotiated, the seller has it within his power to raise money on the sale thru negotiating the note if it should become necessary for him to do so. A note made by a responsible party places it within the power of the seller to realize cash for his transaction without waiting for the buyer to pay.

5. *Action on notes.*—If it becomes necessary to resort to legal processes for the collection of the bill, a note is a far better basis for suit than a book account. In the note illustrated on page 32, the phrase "value received" appears. The effect of this is to stop the signer of a note from disputing the fact that he received consideration for its issue. Once the note has been made and delivered, questions regarding the actual receipt of the goods are subordinated. When the seller brings action on the note, there are only two things that he is required to prove in order to obtain judgment unless the buyer introduces some defense by way of offset to defend the claim. These matters of proof are (1) the genuineness of the maker's signature and (2) the fact that the note was presented for payment and was not honored. The same matters of proof are also required against indorsers. In this connection, it may be observed that the note of an infant (i. e. one under twenty-one years of age) is the same as his contract—it is good unless he sets up the claim of infancy when action is brought on the note. Accordingly the note of an infant is not of itself void but he may interpose the defense if he wishes to.

6. *Drafts.*—A draft, unlike a note, is made by the person to whom the money is owing rather than by the debtor. It is an order on the debtor directing him to pay the amount of the draft either to the order of the drawer or to the order of some third person. The order may be to pay at sight or at

some specific time, such as thirty days. With the growth of the book account, the draft has largely passed out of ordinary mercantile transactions. Its chief use has now come to be an instrument in the collection of past-due accounts. The drawing of a draft and forwarding it to the bank at the debtor's place of business does not change the status of the account or afford the seller any means of utilizing his money immediately. It is only when the buyer "honors" the draft and pays it at the bank that the seller is at all accommodated by this process.

The accepted draft leads logically to the subject of the trade acceptance, which has become widely discussed in credit circles for the past few years. Every trade publication has concerned itself with this apparent innovation in our mercantile system. Hardly a week passes that it does not form the main topic of discussion at some important meeting of business men. Its adoption in a continually increasing number of trade lines marks it as the most important change in our commercial customs for many years past; hence it merits the most careful examination.

7. *Notes, drafts and acceptances.*—In foreign trade, the draft has a standard and recognized place in trade usage, but in domestic trade notes and drafts have of recent years become somewhat discredited. They have not changed their legal nature in the slightest, but as a man is known by the company he keeps, so these instruments are generally known thru association with bad debts. Instead of being, as was

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at one time the case, features in normal credit relations, their use of late years has been to such an extent connected with the collection of debts which are past due that they have in some measure lost caste and standing. The present movement in favor of the use of trade acceptances has for its purpose in a large part to restore negotiable instruments to their legitimate place in the conduct of business.

Two things may be noted at the start regarding the trade acceptance. One is that it is not new and the other is its close relation to the promissory note or the draft already discussed. Up to the time of the Civil War, the bulk of transactions was made by means of the bill of exchange or acceptance. It was customary for merchants to sell on long time credit and to draw on the buyer for the amount of the invoice. The change in business and financial conditions that led to a discontinuance of this practice has already been indicated. The trade acceptance, then, is not a stranger but an old friend in new guise. An indication of its growing importance is seen in the increase in the volume of business done by this means. Up to the year of America's entrance into the war, the amount of business done thru the trade acceptance was almost negligible. In 1917, the amount of business transacted thru the trade acceptance reached a volume of $200,000,000 and this increased to a volume of approximately $800,000,000 in 1918.

8. *Nature and form of the trade acceptance.*— The trade acceptance is nothing more or less than

a draft drawn by the seller upon the buyer to the seller's own order, with the additional feature that the face of the draft contains the statement that the obligation for which the instrument is drawn arises out of a mercantile transaction. A typical form of the trade acceptance is given on page 40.

In a sale on acceptance terms, when Smith sells Brown a bill of goods, he sends attached to the invoice the acceptance instrument. Upon receipt of the invoice, Brown writes his acceptance upon the face of the instrument. The acceptance is then returned to the seller. A note as to how the legal status of the parties is affected will be interesting at this point. Up to the time Brown "accepts" the draft by signing his name on the face of it, the instrument is no more than a piece of paper of no value and creating no liability. Once it has been accepted, however, the acceptance in effect becomes the promissory note of the buyer. This point is brought out in connection with the features of the promissory note heretofore discussed. Consequently, an acceptance, if made contingent upon the happenings of an uncertain event or made payable out of a specific fund or containing other elements of indefiniteness or uncertainty would be open to the same objections that would obtain in the case of the promissory note. Once the acceptance is returned to the seller, he may either discount it at his own bank and so make use at once of the capital represented by the goods he has sold, or else keep the acceptance in much

TRADE ACCEPTANCE

No. _____ New York, N. Y., _____ 191__ $_____

_____ after _____ pay to the order of OURSELVES

_____ Dollars

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer, maturity being in conformity with original terms of purchase. The drawee may accept this bill payable at any bank, trust company or banker's office in the United States which he may designate.

ACCEPTED

To _____

_____

Due _____ 191__

Date _____ 191__ (Date Accepted)

Payable at _____ (Designate bank or place of payment)

Location of Bank _____

Signature _____ (Signature of Acceptor)

the same way that he would keep a promissory note until maturity.

9. *Summary of advantages to the seller.* By the possession of the buyer's signed trade acceptance, the seller is placed in a position where he is no longer so largely dependent on the will and circumstances of the debtor. Thru the ability to discount the trade acceptance at his bank, he can at once obtain the money for the goods sold. So he is provided not only with liquid working capital instead of an open book account, but his line of general credit is improved since, by discounting his trade acceptance, he is not under the necessity of borrowing from the bank on his personal credit in order to obtain working capital and he may retain the use of his general credit for unusual emergencies that arise in the course of his business. The trade acceptance, too, is available for discount at its face, whereas, in realizing on open book accounts, considerable latitude must always be allowed for doubtful accounts.

Of almost as great importance as the financial advantages that accrue to the seller are those which affect the general conduct of his business. Under the easy-going means of book account credit, it is only possible to approximate the amount of future income from outstanding accounts and the times at which these will be paid. In the case of trade acceptances running for a given term, the seller may look ahead and with a reasonable degree of certainty calculate exactly his income from receivables for several

months. The resultant condition of comparative certainty cannot fail to be a considerable benefit to any house that has occasion to compare the two methods of credit granting. Then, in the realm of credit itself, the trade acceptance serves a useful purpose. Where a business goes on the acceptance basis, it may be found that there are buyers who will not purchase under these terms. Since the main reason for this is always bound to be an uncertainty on the part of the buyer as to whether he can meet the obligation at the day fixed, the trade acceptance serves to show up the "dead wood" among a house's customers. Those who purchase under the trade acceptance plan, will generally be found to be good accounts. As a result, the seller has not only fortified himself financially and provided himself with a more certain means of estimating his business condition in future, but it has aided him to build up a better class of trade, a class where doubtful accounts are reduced to a minimum.

Even with the best class of accounts, it is, of course, inevitable that occasions arise when the acceptance may not be met. But in this case, too, the seller has less to worry about than in the case of an open book account transaction. If he has discounted the acceptance at the bank, the bank acts as his collection agent. The men in his organization who spend their time, under the open book account system, in writing clever "dunning" letters are released for more important and more constructive work. And altho it

is inevitable that cases may arise when the acceptance will not be met at maturity, it is evident that the buyer will use his utmost endeavor that this does not happen, for the buyer has a vital interest in maintaining his credit reputation at the bank and he knows that a failure to meet the acceptance on its due date is a matter that will impair his credit standing.

Should it become necessary for the seller himself to take action on the trade acceptance, he has the same facility of proof that he possesses in the case of a man suing on a promissory note. If he establishes the genuineness of the acceptor's signature and the fact of presentment and non-payment, he has a prima facie case. Since the acceptance states on the face of the instrument that it is given on account of the purchase of goods from the drawer, a number of small litigious questions are swept aside. The correctness of the seller's account is not only indicated in the instrument but admitted by the buyer's acceptance.

The value of the acceptance does not stop at its beneficial effects upon the seller's financial and credit position. It extends even to the main business of merchandising. For one thing, the buyer having admitted by his acceptance the correctness of the seller's bill, a long step toward eradicating the "return goods" evil is taken. Then, too, the tendency of the dealer's salesman to overload buyers, where such a tendency exists, is cut down in two ways. In the case of buyers who make use of the trade acceptance,

the salesman must unconsciously or consciously be aware of the fact that to sell the buyer more than he can meet at the due date of the trade acceptance is undesirable for himself, for the buyer and for his own house. In the case of buyers who do not use the trade acceptance, this will be still more pronounced. Here is a class of trade that by its refusal to use the acceptance has classified itself as of doubtful credit standing and no salesman can risk his reputation for discretion by overloading a buyer whose desirability as a credit risk is questioned by his own act.

Another merchandising point to which attention generally has not been directed is the fact that the trade acceptance is a direct aid in increasing the rate of turnover. It is a rule of all good merchandising that money for goods or services should be obtained as soon as possible after the transaction has taken place. Pending such return, a seller must rely upon his bank credit for any enlarged operation and this is in itself a limitation. The success of the dealer's operations, then, is gauged by the rapidity of his turnover. Now, with trade acceptances in hand for all his sales, even tho they may be held to maturity, the seller should be able, with definite obligations, capable of conversion into cash in hand, to enlarge the scope of his operations and so speed up the rate of his turnover thru his enlarged working capital.

10. *Advantages to the buyer.*—Altho the manifold

advantages that accrue to the seller have been indicated, the trade acceptance is not the direct antithesis of the book account in transferring all the advantage from the buyer to the seller. There are advantages accruing to the former no less important than those which the seller obtains. One of the foremost of these advantages is that the trade acceptance is an encouragement to careful buying. It has been shown how, with the open book account method, the buyer's enthusiasm may lead him to overstock or he may do the same thing with an ulterior motive. He has always before him the temptation to buy up to the limit of his credit title, trusting more or less to luck that he will be able to turn over his large stock in time to honor his obligations. With the trade acceptance another and different kind of limit is established. Instead of buying to the limit of his credit title, the buyer will order only to the amount of his ability to meet his written obligations. His regard for his credit standing at the bank will act as a deterrent in taking large amounts of stock, the acceptances for which he may be obliged to default.

It has been seen that the seller reaps an advantage from the trade acceptance in being able to estimate ahead with reasonable certainty the kinds and the amounts of his future income from his receivables. This same feature is an advantage to the buyer. He knows ahead of time just what written acceptances he has coming due. With the loose book account, where a man may know he has bills amounting to

$1,000 coming due within the next two months, there is always the temptation to use this money in laying in additional stock if he thinks it advantageous, or to employ his receipts in some other way than in preparation for paying off the accounts when they come due. Since the acceptance matures at a definite date and will be presented at his bank, he is impelled to make provision ahead of time for taking care of definite amounts at definite periods and the result cannot fail to be beneficial to his entire business. The presence of "trade acceptances payable" on the buyer's balance sheet is indicative both to seller and to banker that he is pursuing modern business methods, that his obligations are being met promptly and that the obligations he has due are for current mercantile transactions. Then, too, the amount of credit which a buyer can command from those who sell to him is often uncertain. The trade acceptance is a step toward clarifying this situation and helping the buyer to know more definitely just what extensions he can command.

As the seller's general condition is improved thru the use of trade acceptances, part of the benefit should accrue to the buyer thru the better terms which the seller is consequently able to offer. Even if this benefit is intangible and no appreciable reduction of prices by the seller is in evidence, the house which uses trade acceptances approaches very nearly the standing of a house which buys for cash. The small buyer therefore is in a better position to compete with

chain stores, mail-order houses and other concerns, which by reason of their very size and capital strength are able to buy on the best possible credit terms.

Then, too, just as the trade acceptance may well aid the seller in increasing his rate of turnover, it can aid the buyer in expanding his volume of business. This may be shown by the case of a house which has before it a transaction presenting attractive opportunities for which an amount of capital, say $5,000, is required immediately. If the buyer should be compelled to go to the bank for this money he probably could not borrow the entire amount. Say that he receives, however, 60 per cent of the amount he wished to borrow, or $3,000. The bank would make its usual requirement that 20 per cent of the loan be left on deposit. Accordingly, the buyer would be left with only $2,400 actual ready cash for the transaction requiring $5,000. Thru the use of the trade acceptance in a transaction of this sort, the buyer should be able to swing the deal for the full amount by giving his negotiable paper.

11. *The bank and the trade acceptance.*—The bank is the good business man's partner. Any change in the credit system that benefits the business man should show a corresponding advantage to the banking system. These advantages are almost self-evident from what has already been brought out. For one thing, in discounting a trade acceptance the bank has two name paper fortified by the signature both of the acceptor and the seller who discounts it.

It is commercial paper of the first class. Then, thru the very nature of the instrument, the bank has the assurance that it has its foundation in an actual business transaction of current date and also that the acceptor of the draft is engaged in business. This makes it extremely likely that the obligation will be met when it matures. The ordinary promissory note gives no indication of its source. The money may have been borrowed to pay a gambling debt, or for any other reason. The presence in considerable volume of so much good commercial paper provides the banks with an ever-increasing field of business and makes it possible for them to extend more liberal facilities to customers than they could possibly do under the open book account method.

The crowning feature of the trade acceptance in the banker's viewpoint, however, is in the preferential rate of discount it enjoys with the Federal Reserve Bank. This preferential rate usually runs about one-half of one per cent lower than the rate for ordinary commercial paper. In order to be eligible for rediscount at a Federal Reserve Bank it is necessary that the trade acceptance run for not longer than three months in the case of ordinary mercantile transactions and for not longer than six months in matters arising in agricultural transactions. A trade acceptance with these stipulated terms of maturity, then, can be rediscounted by the local bank with its Federal Reserve centers at a better rate than any other type of commercial paper, and so it ranks not

only in the first class but at the very top of the business man's negotiable instruments.

A valuable adjunct to the bank is growing up, too, in the formation of discount corporations. The object of these corporations is to provide an open market where prime acceptances may be purchased and discounted. The growth and development of such houses should, in time, provide an open market thruout the country where prime commercial paper such as the trade acceptance may be sold as readily as merchandise. The elasticity such a system would lend to the country's financial system is evident from the mere fact that with such a condition, a business house in possession of buyers' acceptances arising out of commercial transactions would have paper transferrable almost as readily as a bank note.

12. *What is a commercial transaction?*—It has been noted that in order to be eligible for passage as a trade acceptance, the instrument must bear upon its face the statement that the obligation arises out of the purchase of goods or out of a commercial transaction. In this connection the question may often be presented of exactly what limits are set to the definition of commercial transactions. The picture is at once presented of actual goods, such as groceries, steel products or other trade staples being bought and sold in the usual channels of commerce. The trade acceptance is not limited, however, solely to undertakings of this sort. A few examples will indicate the latitude that is extended to the meaning of

commercial transactions. It has been definitely decided that a trade acceptance drawn by the seller of advertising space on the advertiser and accepted by the latter is a trade acceptance eligible for rediscounting at a Federal Reserve Bank. This places advertising space definitely in the category with "goods, wares, merchandise and agricultural products." The proviso that is attached to this ruling is that the advertising must be for the promotion or facilitating of production, manufacture, distribution or sale of goods. However, a trade acceptance drawn by a publisher to cover the cost of advertising a house for sale is not eligible for rediscount. On the other hand if an advertisement is placed for the sale of pianos, it stimulates the sale of goods and an acceptance drawn in payment could be rediscounted.

Another example of an eligible trade acceptance is where the transaction involves the sale of electrical appliances and their installation by the vendor. Even tho the trade acceptance is drawn for an amount including both the installation and the appliance itself, it has been held that this is discountable within the meaning of the act. The same ruling was made in the case of an acceptance drawn upon a gas distributing company by a gas producing company. On the other hand, an instrument drawn for the amount of an insurance premium, it has been ruled, does not arise out of a transaction involving the sale of goods, wares or merchandise and so would not be eligible for rediscount.

13. *Preserving the discount.*—In changing over from long-established credit customs, the question may readily come up as to whether the discount can be retained if the trade acceptance is put into use. There are several ways in which this may be provided for. For instance, the trade acceptance may provide for a discount if it is paid at maturity. Such an acceptance would be drawn for the amount of the order, less the customary trade discount, and contain a proviso that if not paid at maturity, a greater amount, the gross value of the sale, shall be the amount then due and owing to the seller. The same result is also reached thru using an acceptance for the gross amount of the sale but providing in the body of the instrument that if it is paid at maturity, the acceptor is entitled to the benefit of a discount of five per cent on the amount of the invoices.

Houses which sell for cash or the bulk of whose business is on 30-days' time would hardly be concerned with this question and, in fact, the cash sale houses will not be interested greatly in the trade acceptance or any other credit instrument. In the case of houses which sell on longer time than 30 days, however, credit terms may well be introduced providing for exceptional accommodations to those who take advantage of the trade acceptance. This can be done because of the preferential discount rate commanded by the acceptances. An example of such an arrangement would be a sale on the following terms: "Three per cent, 10 days—two per cent, 30

days—one per cent, 60 days trade acceptance; 60 days net open book account." Thru such an arrangement, not only is the buyer strongly induced to take advantage of the trade acceptance privilege, but this advantage is worked out thru the offering of exceptional discount privileges. An example of trade acceptance drawn to take care of the discount feature is given below:

————————after date pay to the order of ourselves ————————dollars, or if not paid until after due date ————————dollars, with interest from said due date at 6 per cent per annum. This acceptance is drawn to cover invoices of————————for goods furnished by the drawer to the acceptor, and if paid at date of maturity gives the acceptor the benefit of a discount of five per cent. (5%) or $———————— on the amount of such invoices.

14. *Other trade acceptance features.*—In some lines of business sales are made at frequent intervals and in small amounts. Where this is the case and it is not found desirable to send a trade acceptance with each invoice, there is no objection to the practice of sending an acceptance for the total amount of the purchases with the monthly statement. Such an instrument possesses the necessary feature of being drawn to cover transactions involving the sale of goods and by lumping all sales in one invoice, the routine of covering numerous small transactions in this way is avoided.

There is the case, too, of the buyer who may wish to pay his accounts some time before the maturity of

the trade acceptance. Where this is the case, arrangements can easily be made either with the seller if the acceptance still remains in his hands, or with the bank if it has been presented for discount. The matter necessary for observance in this instance would be that the buyer give sufficient notice to the seller or to the bank of his intention to prepay.

Cases have also arisen where an acceptance is drawn for the net amount of a bill and payment is not made at maturity. Say a sale is made for $200 gross with a discount of three per cent. If the acceptance is made for $194, even tho not paid at maturity, the seller may recover both the amount of the acceptance and the remaining $6, which may be included as an open book account item. Accordingly, the seller runs no risk of losing the discount even tho the instrument be drawn for the net rather than the gross amount of the sale.

15. *Handling accounts when acceptance is not paid.*—Supposing a trade acceptance is not paid at maturity—what position is the seller in? Of course he has an action at law on the instrument itself. It is assumed, however, that this is the last thing he wishes to do and that, desiring to retain the buyer as a permanent customer and wishing to aid him over the temporary financial embarrassment that has made it impossible to meet this particular acceptance, he is casting about for means of preserving his account in the same liquid form. It might be suggested that another acceptance could be given by the

buyer in renewal of the one that has been defaulted. There would be no legal objection to this procedure. It would not be advantageous, however, from the seller's standpoint. It has been seen that in order to be eligible for discount the acceptance must arise out of a sale of goods, wares and merchandise. While the original acceptance would have its inception in this way, an acceptance given by way of renewal would not arise in such a manner but it would be given to liquidate an outstanding account. Accordingly, the desirable feature of negotiability for discount as an acceptance would not be present. The best means of extending further time to the buyer and at the same time keeping the seller's account in liquid form would be to induce the buyer to give his note at the current rate of interest. The extension of time would be the consideration for the note and in addition the seller has the two-fold advantage of having a negotiable instrument in his possession and of drawing interest for the further use of his capital represented in the goods sold. Some acceptances are so worded as to provide on their face that interest at the rate of six per cent per annum is to run if not paid at maturity. The best practice, however, is to substitute for the acceptance a promissory note of the buyer if this can be arranged.

16. *Retailers and the trade acceptance.*—While the trade acceptance is not an ideal credit instrument for retailers, as has been pointed out, it is possible

that there may be instances where it will be found advisable to introduce it. Such a case might arise in businesses where the articles retailed are large and have considerable relative value as in the case of ranges, stoves, and other similar articles. Where a business of this sort not being on a cash basis might wish to introduce the trade acceptance, it might be done thru an arrangement whereby the buyer would pay a certain amount, say 33 per cent cash at the time of the sale and then execute one trade acceptance for 33 per cent more payable in 30 days and another for the balance payable in 60 days. Such a practice is in effect in some parts of the country and the result has been satisfactory. A class of business such as this furnishes one exception to the general consideration that the open account provides the least cumbersome method of doing business for retailers.

17. *Introducing the trade acceptance.*—However desirable the trade acceptance may be, it is inevitable that in introducing it in lines where open book credit has long been in vogue, a considerable educational campaign will be necessary. The almost universal custom of lines where this has been done has been to send out a letter with the trade acceptance, explaining concisely what it is and why the selling house wishes to introduce it. Once a campaign to introduce the trade acceptance has been launched upon, however, the selling effort should not be half-hearted. The selling house must make it plainly evident to all

its customers that it has gone on the trade acceptance basis; that buyers who use the trade acceptance will be regarded as in a class by themselves as a credit risk and that failure to take advantage of it may *per se* redound somewhat to the disadvantage of the credit title of the house which does not use it. Variations on this may be notes which simply take it for granted that the advantages of the trade acceptance are known and that the acceptance by the buyer is regarded as a matter of course.

A wholesale house in New York sends out trade acceptances in the following form. Attached to the acceptance itself and capable of being detached thru a perforated line is a memorandum of the same size giving the following explanation of why the acceptance is forwarded and containing the suggestion that its use is regarded as a matter of course.

DETACH AFTER SIGNING

A TRADE ACCEPTANCE

Is an acknowledgment of a debt by the buyer in favor of the seller, for merchandise that the seller had placed in the hands of the buyer with which to pay this debt. The buyer agrees to pay at a certain date, at his own Bank, to the seller, the amount of this certain indebtedness by writing across the Face thereof, "Accepted", the date, and name of his own bank and his signature thereon.

This varies from the open book account method only in giving the debt a negotiable value.

According to a FEDERAL BANK GOVERNOR'S OPINION, the *signing of an Acceptance increases the financial standing of the giver,* because it shows prompt paying methods.

Kindly sign attached Acceptance, then forward to W. & J. Sloane, Fifth Ave. and 47th St., New York.

18. *Future of trade acceptance.*—An old legal maxim runs substantially this way: "When the reason for the law ceases, the law itself is silent." The trade acceptance and the modern credit system present an analogy in the commercial world. The primary reason for cash discounts has long passed. Credit is on a sound basis. The Federal Reserve Act will tend to prevent excessive tightness in the future. With the entrance of the United States into world citizenship and the abandonment of our provincial position of isolation from the world channels of trade, it is becoming increasingly desirable to adopt the trade systems and methods similar to those in use among other great commercial nations. Especially is this desirable with an instrument that contains within itself the advantages to buyer and seller and to the country's banking and financial structure, that the trade acceptance carries.

REVIEW

What do you understand by "documentary" credit as distinguished from book credit?

What are the chief distinctions between notes, drafts and acceptances?

Summarize the advantage of the trade acceptance from the seller's point of view. From the buyer's viewpoint also.

What is the bank's function in the handling of trade acceptances?

Discuss the trade acceptance as applied to retail trade.

CHAPTER IV

GRANTING CREDIT—PERSONAL CONSIDERATIONS

1. *What limits credit.*—The limitations on the amount of credit and on the length of time for which credit is to be granted, adopted by the manufacturer or dealer will be governed by three considerations. (1) What kind of man is the applicant? (2) How is he conducting himself and his business? (3) What is the business he is conducting?

The answer to the question propounded in the first of these considerations "What kind of man is the applicant?" is fundamental in any association or business relation where credit is a factor. It is the basis of "personal credit." On it the wholesaler and the retailer alike judge the advisability of trusting their customers. The manufacturer and the wholesaler and in fact every credit grantor must consider with other factors the character and capacity of his customers, their willingness to cooperate, as well as their capital resources.

2. *Personal credit.*—Altho personal credit was the first kind to come into existence and thus is the oldest, the granting of such credit has not yet been organized systematically. This fact need occasion no surprise, however, if we take into account the conditions under which such credit is usually granted. Each separate

extension of such credit is made to an individual member of society whose relation to others, in his capacity as an individual consumer, is not placed on record by means of public ratings of his capital or character, as is the case with the applicant for commercial credit. The great differences in the economic status of those who wish to buy on credit, goods for their own consumption, render almost impossible the establishment of a uniform credit policy on the part of the dealers from whom they buy.

3. *Deciding when to grant personal credit.*—The injudicious extension of personal credit has a twofold effect—an influence upon the commercial system as a whole and an influence upon prices. If the retail merchant cannot collect his debts when these are due, he may be compelled to ask the wholesalers from whom he buys his goods to wait for payment. Producers and manufacturers, therefore, are compelled to suffer the restrictions that are put upon their business activities by failure to meet their obligations promptly and sometimes by fraud on the part of their customers. Ultimately, of course, the penalty for all this looseness with regard to the observance of credit terms is paid by the consumer in the form of increased prices. This is made necessary because the commercial world must assume the added risk of bad debts.

Every credit transaction embodies two characteristic features: One is that such transaction involves the future; the other, that it constitutes an implied con-

tract. Hence, in endeavoring to determine whether an applicant is entitled to credit favors, the credit grantor must take into consideration, first of all, the probability of the credit-taker's being able to make payment at the expiration of the credit period—whether this be thirty or sixty days or longer. He must also consider the probability of the debtor's being willing to do so. To make the transaction safe from a credit viewpoint, there must be present both ability and willingness to pay.

The first of these considerations necessarily takes account of the applicant's business capacity and financial strength; the second, of his integrity or moral character.

Obviously, there is an element of risk in every transaction that involves the future. Of every credit transaction, therefore, this is true. The credit grantor must assume this risk, tho he tries, of course, to reduce it to a minimum. In other words, he takes due account of all the factors that bear upon the probability of the account's being paid when due.

4. *Moral character in its relation to credit.*—Since the two factors, business ability and financial strength, have to do with the credit seeker's ability to make payments according to terms of sale, his willingness to make such payments is another matter and is equally important. Such willingness depends upon moral character. Where personal integrity is lacking, the creditor's capital, with which the debtor has been intrusted, is always in greater danger.

Here, however, we should distinguish between different degrees of culpability even tho the final outcome may be the same in every case. Thus we have the dealer who deliberately plans to defraud his creditors of their capital. He is a swindler pure and simple. Less pronounced, tho from the credit grantor's viewpoint, perhaps even more dangerous, is the easy-going, self-indulgent debtor thru whose laxity and disregard of moral obligations confiding creditors are robbed of their capital. The mistake is frequently made of treating the latter class of delinquents as tho they were to be pitied rather than blamed. It is sufficient to point out that no man is blameless who diverts to his own use funds belonging to another. Even tho such a dealer has no deliberate purpose to defraud his creditors, he is nevertheless unworthy of consideration as a proper credit risk. His business does not "owe him a living" unless he actually earns it. When this "living" has to come out of the creditors' capital, the boundaries of business integrity are clearly being overstepped.

5. *The good moral risk.*—In studying the credit-seeker's title to consideration on the ground of moral character, the credit grantor will of course inquire whether he possesses honesty, good personal habits, diligence in business, frugality and punctuality. Taken together, these determine the applicant's title to be considered a "good moral risk."

No one element stands out as paramount among the various factors of which a credit title is composed.

It has been said by some whose right to be heard on such a question cannot be denied, that character is the only thing to be considered in determining a credit risk. That a good character goes a long way in business is not in question, but that it is sufficient in and by itself to secure present possession of goods or funds on promise of future payment may well be doubted. The bank when making a loan usually looks well into the nature of the collateral no matter how high the moral standing of the borrower. The same practice obtains in every properly conducted mercantile establishment; the material assets of the credit-seeker come in for just as keen scrutiny as does his personal integrity—not infrequently they receive even greater consideration.

Moreover, whatever the financial strength and personal integrity of the credit-seeker, unless he also possess a certain amount of business ability he is not likely to be permanently successful. Hence, to say that character is the only thing to be considered in passing upon a credit risk is to ignore commonly observed facts, unless indeed the term "character" be made broad enough to include such business ability as, when coupled with integrity, almost invariably insures business success.

The foregoing statement applies with equal force to a wholesale and to a retail business. In the latter case as has already been suggested, it is not always easy for the credit grantor to assure himself as fully as he would like that his customer is entitled to the

trust he is asking. Consequently, the retailer's individual risks are larger, tho the separate amounts involved are usually smaller than in the wholesale trade, where the amount of a single sale frequently runs into thousands of dollars, and where the percentage of profit on each sale is necessarily smaller than in the retail trade.

6. *Mercantile credit.*—The second consideration in granting credit to an applicant "How does he conduct his business?" is the basis of mercantile credit.

Since mercantile credit applies to all those trade interchanges which relate to the distribution of goods, the latter function includes so many and such varied credit operations that special institutions and agencies have had to be provided in order to facilitate such operations and make them safe. Banks, brokerage houses and commercial agencies are among the institutions that have been called upon for help in effecting such transfers of goods.

The mercantile credit system of today has been developed slowly and according to the demands of trade. As commerce grew, the entire system of distribution gradually underwent a transformation. With the development of the country westward and southward, new conditions of distribution arose, owing to the widely separated markets. As the distance grew between producer and consumer the risk involved in credit sales also grew, while the difficulty of adjusting present and prospective resources to the present and prospective needs for an increasing

number of communities made itself increasingly felt. This was true of local, national and international markets.

The modern mercantile credit system may be said to be complementary to the commercial system, since the former adjusts itself to the latter and thereby protects it. In the West and South the new communities needed capital with which to develop their natural resources. By means of credit they were enabled to overcome the difficulties which confronted them in the beginning of their enterprises. At that stage a tendency to speculation developed in their midst, at times sweeping over an entire community. However, as they gradually acquired a more settled condition, these communities learned to abandon their speculative tendencies and to be more conservative in their commercial transactions.

In the wholesale trade it is absolutely necessary that definite credit principles be established and that certain standards be fixed by which every applicant for credit may be measured, so that the risk involved may in each case be determined with reasonable accuracy. We shall indicate briefly the lines of reasoning upon which credits are granted in the wholesale trade.

7. *Business ability, native and acquired.*—Other things being equal, the person who possesses native ability has a distinct advantage over his less fortunate competitors. The keen-witted, able-minded, aggressive man is far more likely to succeed in busi-

ness than the dull, slow-thinking and easy-going one. Acquired ability, however, may be just as valuable an asset and frequently, it may be regarded with even greater favor by the credit-grantor. Business ability may be considered under the technical and financial heads.

8. *Technical ability.*—The careful manufacturer or wholesaler before extending credit to a retailer will always assure himself that the latter "knows his business." This expression, however, may be made to mean much or little, according to the standard of the investigator. For example, it may mean merely that the credit-seeker knows quality and prices, or it may imply a broad and thoro understanding of materials, manufacturing processes, selling qualities and markets. It may also include a knowledge of store-keeping from the viewpoint of attracting and holding trade by means of well-kept store premises and neatly arranged, well-displayed goods, together with courtesy and tact on the part of the proprietor and his helpers. Lastly, it may also be made to imply his possession of that selling ability which insures the turning of his capital a sufficient number of times a year to make the business profitable. No one questions that the more ability of this sort a credit-seeker possesses, the clearer will be his title to credit favors.

In the experience of credit-grantors, there is constantly brought to light an amazing amount of what is commonly called "dry-rot" in the management of business concerns. Slip-shod methods of conducting

business, coupled with unprogressiveness in manufacturing and selling processes, are responsible for a large percentage of failures. One bank, in response to an inquiry regarding the credit title of a local manufacturer, answered: "It is an old mill, operated by old machinery, carrying an old mortgage, turning out old-style goods sold in an old-fashioned manner." This designation would fit more than one concern, and describes the condition of "dry rot."

9. *Knowledge and experience.*—Thoro technical knowledge is not rapidly acquired. It comes only with experience. The inexperienced man who "goes into store-keeping," is handicapped from the outset and finds the chances of success decidedly against him. Such a man might be likened to a ship without a rudder. In the choppy sea of competition, such a craft, if not swamped at the very start, is almost certain, sooner or later, to meet destruction upon some hidden reef or rocky shore. Not infrequently, farmers, in their desire for an easier life and larger profits, become storekeepers; but their training and experience are of little value to them in the conduct of a store, and they usually discover their mistake before long, tho not always before their small capital has been exhausted. For this reason, inquiry should always be made with regard to the length of time the credit-seeker has been engaged in his present business.

10. *Buying methods.*—Nowhere, perhaps, is technical ability more clearly demonstrated than in a merchant's buying methods. This applies with special

force to the retailer, tho it is also true of the manufacturer. Among those of the former class, overbuying is an ever-present danger. The mistaken policy of many wholesale houses that emphasize quantity in the sales made to customers and that instruct their salesmen to "load 'em up," is largely responsible for this. So also is the ambition of salesmen to "make a record" for sales and to increase their own earnings where these are computed on a percentage of sales.

Obviously, the retailer should not buy more goods than he can create a demand for and thus dispose of, no matter how excellent their quality or how low their price. Many business failures are the direct result of overbuying, and well-managed supply houses regard this practice as one of the most insidious evils that affect the life of a retail business.

Indeed, well-managed credit departments are constantly on guard to prevent such a condition. The credit manager of the Carnegie Steel Company, in discussing the company's credit policies, said:

> We believe it poor business to allow a customer to be overloaded with steel, even tho the fault may be with his own purchasing department. While there have been times when it would have been possible for us to ship large tonnages and collect the full charge from our customers for such materials, we have as far as possible protected our customers against this dangerous practice of tying up too much capital in stock.

The ability to determine for himself just what goods will be needed for the coming season or credit

period and, having determined this, resolutely to limit his purchases thereto, gives evidence of technical ability in the retail merchant.

In the case of the manufacturer, buying ability will show itself more especially in the care with which he provides for an adequate supply of raw material to carry out contracts for the delivery of fixed quantities of the finished product during a long period and at fixed prices. Unless precaution is taken to insure a sufficient amount of raw material at favorable prices, the contract which was expected to yield a handsome profit may turn out to be not only a bar to such profit but a drain upon the very life-blood of the enterprise itself. The wise credit-grantor will look carefully into these conditions before establishing credit relations with either retailer or manufacturer.

11. *Judgment.*—The ability to forecast the trend of trade and, in the case of a manufacturer, to turn one's attention to the production of goods for which a present demand is being developed, augurs well for the success of the enterprise. Fortunes have been made thru a correct anticipation of a fad, a fashion, or a want created by peculiar conditions. On the other hand, over-readiness to cater to what may prove merely a local and short-lived fancy on the part of the public involves risk, the extent of which is measured by the cost of the new or newly adjusted equipment which is necessary and by the value of the material and labor employed.

Such errors of judgment, however, may take place even in the production of staples. Unless the manufacturer keeps in touch with market conditions in his line of trade and with the trade situation in general he may find himself with a large quantity of manufactured goods on his hands for which there is no present demand except at sacrifice prices, thereby imperiling his profits and exposing himself to financial embarrassment that may render him dangerous as a credit risk.

Conservatism, alertness and business acumen must at all times be combined to secure the best results in buying.

12. *Equipment.*—Just as undue optimism on the part of the retailer often leads him into overbuying, so a season's good business may lead the manufacturer to think that by enlarging his equipment and manufacturing facilities he may correspondingly increase his profits. Accordingly, he will sometimes reduce his quick assets in order to build an addition to his factory or instal new machinery, and as a result a fairly good business may be crippled. It may easily happen that the next season will prove as much below the average as the first one was above it, and that the temporary flurry was mistaken for the beginning of a permanently increased demand.

On the other hand, well-kept and modern machinery, suited to the needs of the plant, is indispensable to economical and profitable production. Unless the equipment can produce goods in proper quantity and

quality, the manufacturer will not be able to meet the existing competition for business in his line.

It is necessary that the credit-giver be able to discriminate between legitimate, conservative enterprise on the one hand, and unreasoning optimism on the other.

13. *Advertising.*—At first sight it may appear a little fanciful to include advertising among the factors that determine a credit risk. Yet insufficient or wrongly placed advertising may seriously limit the sale of a season's output, just as wasteful and indiscriminate advertising may add so large a burden to the cost of marketing the product as to cut down profits to a dangerous point. Too much or too little advertising, its quality and the mediums selected for it—all are items of importance to the intelligent credit-giver and demand careful consideration in the determination of credit title.

14. *Location.*—The location of a retailer's store is an important factor in the success of his enterprise. The dealer is confronted with the necessity of balancing desirability of location with the cost of rents. Error may easily be made in either direction, and the vitality of the business may thereby be unduly taxed. Again, a change of location after a business has become established may, or may not, be advantageous. Conservative retail merchants generally prefer not to move, as it is rarely possible to take along more than a small part of the trade built up

at the old location. In cases where the character of the old neighborhood has altered, changes of location have, at times, been the means of turning a small and unprofitable business into a large and prosperous one.

The manufacturer scarcely less than the retailer is affected by the question of location. His freight expenses depend on the distance to the market; the absence of railroad sidings means larger drayage charges both to and from the plant; even the quality of labor obtainable is often influenced by the accessibility of the factory—all of which, since they affect the success and permanence of the business, are matters that demand thoughtful consideration from a credit viewpoint.

15. *Age.*—In determining a credit-seeker's business ability it is necessary to consider his age. A too youthful merchant frequently lacks the stability and perseverance necessary to success in business. He may have started out enthusiastically, yet after a few months' experience he may begin to doubt the wisdom of remaining in business. He may conclude that he would like to try something else or go somewhere else, rather than fight out the battle he sees before him.

Immaturity of judgment exposes the youthful merchant to certain errors less likely to occur in the case of his more seasoned and experienced competitor. Inclination to overbuying, too great op-

timism with regard to collections—in short, all the dangers growing out of lack of experience and business ability are present in his case.

On the other hand, youth is aggressive and ambitious. It readily adapts itself to modern methods, and is willing, as a rule, to be taught. This cannot always be said of the man of advanced age. In his case, tho we shall necessarily expect to find more mature judgment and greater fixedness of purpose, we may also find that only with difficulty does he adapt himself to newer merchandising methods. He is likely to insist upon doing things in the old way, even tho that way be obsolete and out of tune with the spirit of the present day. In competition with merchants of more progressive ideas, such a merchant usually fares ill. Moreover, the struggle and conflict that to some extent are always present in commercial life are not usually relished by him; hence that aggressiveness which our competitive system demands in a successful merchant is likely to be lacking in the merchant of advanced age.

There are of course no fixed points beyond which on either side a credit applicant is to be judged as too young or too old, but in estimating his business ability as a basis of credit the credit-grantor should take into consideration the applicant's age.

16. *Evidence of financial ability.*—Usually, but not invariably, a fair measure of financial ability goes with pronounced technical ability. A dealer may have a mind that runs to analysis and to a study

of details; he may understand how to attract and hold trade, yet for all that be an indifferent financier. No business can be very successful unless its management possesses good financial ability. A retailer must be able to regulate his finances so that he always has funds on hand with which to meet his merchandise bills as these fall due. To that end he must be a good collector, and must also maintain a certain definite relation between sales and outstandings.

The small dealer who possesses financial ability will resolutely refrain from attempting to do a larger volume of business than his capital warrants. Where such ability is lacking, the book accounts will soon be disproportionately large and a corresponding portion of his working capital will be tied up in accounts that month by month depreciate in realizable value.

The dealer's financial ability manifests itself also in other ways. Old and shop-worn stocks will be sold at a sacrifice rather than be permitted to accumulate additional age and unsalableness in the store. Economy in the matter of expenditures will be practised at all times. No needless help will be kept and no extravagance permitted, either in the conduct of the business or in the proprietor's personal expenditures. Exact accounts of expenses and of the cost of doing business will be assiduously kept—the case in this respect differing greatly from that of many dealers who do not know even approximately at what cost they are doing business and who as a

result supply the bankruptcy court with most of its business.

17. *Outside ventures.*—Frequently, impelled by a desire to increase their profits, dealers invest in outside ventures, when to do so involves a weakening of their condition thru withdrawal from their regular business not only of a part of their capital, but also of a considerable part of that time and attention which their business constantly demands if it is to thrive. All such temptations the merchant of good financial ability resists. He will do nothing that may imperil his credit. He fears delinquency and loss of credit standing more than he fears the loss of a possible profit. He never allows himself to be crowded too close to the limit of his resources, but always holds in reserve some source from which funds may be obtained for use in an emergency.

18. *Distribution of due dates.*—Financial ability is seen in the proper distribution of the dates for maturing bills payable. The wise dealer will not permit his obligations to be "bunched" so that they all fall due about the same time, but will see that they are distributed over the year in such a manner as to insure his ability to meet them without embarrassment to himself or danger to his business, and so that he may employ his credit at the bank to the best advantage for that purpose.

The cultivation of confidential relations with his banker is further evidence of a merchant's financial ability. Owing to his knowledge of markets and in-

dustrial conditions, the banker is in a position to assist the merchant in a number of ways if he is kept informed of all essential facts relating to the merchant's business. A great deal of valuable credit information is also held by the modern banker. He is generally quite ready to pass this information on to other bankers, and receives in return credit information that is of interest to him and that may be of value to his customers.

19. *Cooperation with mercantile agencies.*—The manufacturer or merchant who keeps in close touch with the large commercial agencies, meeting their requests for information in a spirit of cooperation and mutuality, gives evidence of possessing financial ability. In common with the banker, the commercial agency man is in possession of much information that is of value to the merchant, and is often in a position to give good advice. Nothing is lost by cultivating the confidence and good-will of the agency representative. Few merchants can afford to treat the agencies with indifference, for the ramifications of the modern credit structure are such as to touch at some point everyone engaged in business. Such important credit institutions as the large commercial agencies, Dun's and Bradstreet's, should have the cooperation of every business man who in this day of rapidly changing conditions would establish and maintain his credit standing.

20. *Insurance.*—The matter of insurance will also receive due attention from men with ability in finance.

The amount of the insurance to be carried as well as the responsibility and reliability of the insurance companies selected will always be carefully considered, as well as the requirements of the insurance companies with regard to the installation of appliances and establishment of rules which reduce the cost of insurance.

Other forms of insurance, such as burglary insurance, earthquake insurance, flood and tornado insurance, when the nature of the business or the local conditions make these desirable, will not be neglected by the business man of financial ability.

21. *Payment methods.*—The outward and direct evidence of the possession of financial ability, as that term is here used in connection with the retail merchant, is of course promptness in meeting financial obligations. That is why as a rule the intelligent credit grantor inquires so carefully into the applicant's "payment habits." An untarnished credit reputation is indeed one of the greatest assets a business man can have. Once this credit title becomes clouded or impaired it is extremely difficult if not impossible to restore it to its former condition.

Injured credit has aptly been compared to a broken piece of beautiful porcelain; you may put it together again and it may seem as good as of old, but the cracks are there and you cannot forget that it was broken.

22. *Financial strength.*—From the foregoing con-

siderations we conclude that where both technical and financial business ability are present and sufficiently indicated, the credit-seeker has a strong claim to be considered a desirable credit risk. But even with such ability fairly marked, his credit title will be much stronger if he also possesses capital sufficient to afford a guaranty of paying ability in the event that misfortune of one kind or another should overtake him. Business contingencies are so numerous and so difficult to anticipate that a certain amount of reserve in the form of realizable assets is necessary if the risk is to be acceptable to a conservative creditor. That a dealer's assets should exceed his liabilities is a necessary condition of his legitimate commercial existence. Unless they do he is insolvent, and hence without any credit title whatever.

23. *Capital—how acquired.*—While at first glance it may seem a matter of little importance how a dealer's capital was acquired, yet on closer consideration it is seen that this after all has a direct bearing upon his credit title. Five thousand dollars in the hands of a man starting in business is not nearly so much of an asset if it was inherited, as if it was the result of frugality and saving on the part of the merchant himself. During the years it has taken him to save up that sum, the merchant will have learned thru self-denial and frugal living to know the value of money, and the knowledge thus acquired is not likely to desert him when he starts in business for

himself. He is almost certain to continue his practice of frugality and is accordingly not likely to spend his hard-earned dollars foolishly.

When the capital has been acquired otherwise than by dint of personal exertion and continued saving, there is not the same assurance that the funds will be judiciously handled, as is the case when the merchant has earned the money himself. The beginner in business who finds himself in possession of capital before he has learned to take care of it, is in danger of losing his money thru ignorance and inexperience. "Acquiring the needful experience and education should always precede the employment of capital; but where the experience and education are undertaken to be gained concurrently with the use of capital, there is always danger that the latter will be lost before the former is gained."

24. *The customer who makes unjust claims.*—In addition to the dealer who seeks credit with a deliberate intention to defraud, and the one whose laxity of business methods causes loss to his creditors, there are those who do not hesitate in other ways to take advantage of confiding creditors. They will cancel orders and return goods for trifling or for purely imaginary causes. They will, without justification, set up claims for rebates and will deduct from their bills cash discounts long after the expiration of the discount period. Thru pilfering of this sort the wholesaler is deprived of profits that rightly belong to him, while his increased cost of doing business must

be borne, in part at least, by those of his customers who deal fairly with him.

With decreasing profit margins, due to growing competition, the injustice of such practices is being felt more and more by wholesalers, and the protests against these evils are becoming louder and stronger year by year. Many credit grantors have taken a definite stand against them.

REVIEW

What are the personal qualifications which make for the safe granting of credit?

What business qualifications indicate applicant's fitness to receive credit?

Give a concise definition of technical ability as herein applied to a merchant.

What is your view with regard to the often heard statement that character is the sole basis of credit?

CHAPTER V

GRANTING CREDIT—BUSINESS CONSIDERATIONS

1. *Importance of business methods.*—In the preceding chapter it has already been shown how important are considerations of business methods in determining whether, and to what extent credit should be granted. The credit man of a manufacturing or wholesale distributing company in a definite line of business will gradually acquire a very clear idea of the business capacity of the dealers who buy thru his house. Thru his analysis of financial statements and by other less obvious signs, he will recognize at once whether the man is or is not a good merchandiser.

It is plain that if a man is a good merchandiser he can obtain almost unlimited credit from the wholesale house, provided he is in a line of business in which he can dispose of the goods purchased within the usual credit period. On the other hand, the buyer who is slow in selling his goods, cannot rely upon the proceeds of the sale to meet his obligations.

Under the latter circumstances the credit man would know that if credit was granted he would have to rely to a large extent on the other resources of the debtor. It is clear, therefore, that every application for credit will, as stated in the preceding chapter,

be tested by an estimate which the credit man forms of the way in which the applicant conducts his business.

2. *How credit is affected.*—If the men in the same line of business conduct their affairs with different degrees of ability and success, it is clear that this must have a marked effect upon the credit which is granted to them. In any given trade, the usage of the trade generally prescribes certain definite credit periods. It is as a rule hardly within the power of the seller to extend the limits of the credit period to dealers who may be good pay, but slow sellers. In fact, sellers cannot afford to do so unless they are compensated for such an extended credit by an increase in prices. Since such an increased price would involve not only interest upon the capital so invested, but a compensation for tying it up in such a way that the seller cannot use it during the interval, the latter is unwilling to make extensions of credit on this basis. The dealer, too, in such a case would feel that he was being considerably discriminated against, and refuse to pay the higher price.

Variations in the credit terms are not, therefore, so frequent as variations in the amount of credit extended. The poor merchandiser will not be granted so large a credit as the good merchandiser. His methods of doing business do not entitle him to the same considerations. The seller must rely less on his business ability in disposing of the goods and more upon his general financial position.

The rapidity with which dealers in any line of busi-

ness dispose of their stock varies, but it is coming to be recognized more and more that in each line there is a certain average or normal turnover. If any given merchant has been successful in passing beyond the average, he may be granted more than the average credit in relation to his resources. If, on the other hand, the merchant falls below the average turnover, the prudent manufacturer or wholesaler will be obliged to curtail more or less the credit which may be granted him. This explains the fact that two men with equal amounts of capital invested in business may be able to secure very different amounts of credit from the manufacturers and wholesalers from whom they buy.

3. *Differences in turnover.*—The credit man of a commercial house has as a rule to deal with applicants who are in a single line of business with whose conditions he is entirely familiar. Consciously or unconsciously, he recognizes that there is in his line a normal type of successful merchandising of which the normal turnover is one of the characteristics with which he is most familiar.

The credit man of a bank must, however, have a broader outlook. He is concerned not with one business enterprise, but with a large number of different concerns in varied lines of business. To fill his place with success, he must know something of the chief characteristics of the leading lines of business. This he gets in part from his own experience, but if he is wide awake, he will secure information

from many and varied sources. Somewhat in the same way the credit grantor in a line which is sold by variety stores carrying many other lines besides his own finds it very necessary to know something of the normal turnover in these other lines in order that he may thus get an idea of the customer's ability.

There is coming into existence thru the work of credit men's associations, the Bureau of Business Research of Harvard University, the work of the advertising agencies and special research organizations and similar agencies a vast amount of knowledge about the detailed operations of the different classes of business enterprises. Retail stores are not as alike as two peas. Each line presents its own problems. A man who has been successful in handling a grocery business would not, unless he has given thought to the principles of merchandising, make a good manager for a hardware store. The principles may be the same, but the routine and the conduct of the business may be quite different. It is a common-place of modern business literature that the turnover in the retail lines varies considerably.

The details of these experiences do not concern us at this point, but it may be noted that considerable progress has been made in the analysis of the different types and in some, not only has the annual turnover been established, but the obvious fact that the turnover from month to month and from season to season is fairly uniform has been measured by exact figures. In the same way, we now have some definite

knowledge of the changes in the rapidity of the turnover which takes place in lines of business into which the seasonal element enters as the controlling force. The analysis has been pushed further and has shown us that different conditions prevail as respecting turnover according to the location of the store, being less rapid in the country stores than in the corresponding city stores or corresponding departments of city department stores.

Our present concern is to inquire how these typical conditions in business enterprises which we have suggested in this discussion of turnover affect the granting of credit.

4. *Amount of credit affected by turnover.*—After all the fundamental nature of mercantile credit is an advance to the retailer to be repaid in whole or in part from the latter's sales of the goods entrusted to him. If the duration of the credit is sufficient, the advance can be repaid wholly from the proceeds of the sales. If the credit is a brief one, the advance must be repaid from other resources of the dealer.

These features must be taken into account in granting credit for short periods to persons in different lines of business. This is particularly the problem of the bank credit man where loans are made for short periods. Other things being equal, he will be more disposed to grant a larger credit to the dealer whose business has a rapid turnover than to one where the turnover is slower. This, of course, is the converse of the familiar proposition that it requires more

capital to engage in some lines of business than in others. The phrase would be without meaning if it simply stated that in any given line of business the larger the sales the larger the capital required to conduct them. Its significance lies in the fact that for a given volume of business, more capital is required in some instances than in others. As we have seen, this is due to the fact that for certain lines of business credit is more easily obtainable than for others.

5. *Duration of credit.*—If we go back to the idea that credit is an advance to be paid for in the sales of goods, it is obvious that the advance can not be repaid wholly from the proceeds of the goods, until they have been sold. The credits granted by manufacturers and by wholesalers take this consideration into account to some extent in fixing the duration of credit. The customary credit usage in different lines of trade varies considerably. The usual credit periods are 30 days, 60 days and occasionally 90 days. The longer periods are granted in lines which are relatively slow sellers. A further extension is frequently given especially in seasonal lines by the practice of dating accounts ahead. Thus, woolen piece goods are sold at 30 days, 60 days or 4 months' credit, but with the season dating, which is January 1 and July 1. Under these arrangements, a man who buys in August at 30 days' credit has his bill dated January 1 of the following year. The fact that credit is extended in some lines beyond the limits used in others does not necessarily imply that the difference in time

enables the dealer to dispose of the goods. Between two lines in which, for example, a 60 day credit limit is customary, there may be one in which a much larger percentage of the goods can be disposed of than in the other. This being the case, it brings us back to the thought of the preceding paragraph that the difference in the type of business will affect the amount of credit which may safely be granted.

If a wholesale store handles, for example, carpets, which are relatively slow sellers and ready-to-wear garments, which are sold more rapidly, one can readily see that it would have different standards for judging credit applicants in the carpet line from those which it used in the other.

6. *A study of business types.*—The influence of the business type upon the granting of credit finds expression in the practice of manufacturers, merchants and bankers. A recognition of the principles has thus far been more or less instinctive, and it lacks a clear scientific definition. This is due in part to the fact that we have only made a beginning in classifying and studying business enterprises in such a way as to identify and formulate typical conditions. As already indicated there is much research of this nature going on. There can be little doubt that as it advances, much light will be thrown on merchandising and credit problems.

Despite the irregularity noted in credit terms offered by different lines of business, certain general principles have gradually been evolved for guidance.

For example, in a seasonal business, like ladies' garments or millinery trade, settlement for purchases is generally made twice a year—Spring and Fall. While the commodity is in demand the year around, or where its sale is not greatly affected by the seasons, payment periods come more frequently as a rule. Articles that afford a liberal profit margin are usually sold on longer terms than those that are sold on a smaller percentage of profit.

Products for immediate consumption, such as articles of food, are almost always sold on short credit terms, perishable food being sold practically on a cash basis. Nearly everywhere, however, one finds considerable latitude not only in the matter of terms given but also in the degree of strictness with which customers are held to the terms agreed upon.

The credit terms that obtain in some of the more prominent lines of trade are briefly discussed in this chapter. It should be remembered, however, that local customs and peculiarities frequently effect material changes in credit terms. The following describes the credit customs that are prevalent in the larger cities of the East.

7. *Customary credit terms in the grocery business.*—The wholesale grocery business is compelled perhaps more than any other line, to deal with a large number of untrained and otherwise incompetent retail merchants. In our larger cities, particularly, where there are large foreign sections, many of the grocery stores are in the hands of foreigners who have

little or no knowledge of the English language or of American business methods when they begin business. As these merchants rarely have any capital worth mentioning, they necessarily depend upon credit at the hands of the wholesaler for the goods which they buy and sell. As a result of these conditions, the abuse of credit terms is common in the grocery trade, and the return of goods for no valid reason is also a frequent occurrence. These strictures, however, do not apply to that large number of intelligent and business-like retail grocers that are found in nearly every community.

Speaking from a credit standpoint, we may say there are three classes of goods sold by the wholesale grocer. The class which constitutes the larger part of the goods sold in groceries includes what are called "shelf goods." Such goods are generally sold on terms of thirty days net, one per cent discount being given for cash in ten days, or as commonly written, 1/10/30. In some sections, however, this class of goods is sold on terms of sixty days net and one and one-half per cent discount for cash in ten days, or 1½/10/60.

The second class is made up of such articles as butter, eggs and (usually) sugar. On these goods the terms are thirty days net and no discount for cash. Sometimes when sugar is sold along with "shelf goods," it is sold on the same credit terms as the latter, that is, with a discount for cash payment. The third class consists of teas, and these are generally

sold on terms of three to four months, with a discount of three per cent for cash within ten days. It follows, therefore, that a single shipment of groceries may have to be billed in three different ways, when the goods shipped include the three classes here enumerated.

Investigation of a new grocery account is left largely to the local salesman. If he recommends the account, the order is generally filled without further investigation, except that the mercantile agency's rating book may be consulted. So largely is this practice followed that in many wholesale grocery houses the salesman is virtually also the credit man in his territory. He is expected to see that all accounts are promptly paid, and while he is not held legally or financially responsible for them, he is responsible in a moral sense.

Few wholesale grocers appear to insist upon the customers' strict observance of credit terms. Accordingly, the discount period is not infrequently lengthened by the customer without the formality of first obtaining the creditor's permission for an extension. Likewise the thirty or sixty days, as the case may be, are often extended considerably beyond the credit limit imposed by these terms. This evil is being vigorously resisted in certain other lines, but appears to have met but little concerted opposition in the grocery line.

8. *Customary credit terms in the hardware business.*—The metal trade is highly diversified and sub-

ject to many influences of which no account can be taken here. In general, however, what is commonly classed as hardware is composed of "builders' hardware" and "shelf hardware."

Builders' hardware is usually sold to contractors, many of whom are not financially strong and in view of the more or less hazardous nature of their business are not regarded as specially good credit risks. In many instances, therefore, such contractors are required to pay 85 per cent of their month's purchases on or before a certain day of the month following—in some cases, the tenth day, in others the twentieth. Under this arrangement the remaining 15 per cent is not paid until thirty days after the completion of the building operation into which the supplies enter.

The regular credit terms in the hardware trade are 2/10/30, which means two per cent off for payment within ten days of invoice, or net thirty days. Considerable latitude exists, however, in the observance of these terms, a common practice being to give two per cent e. o. m. (end of month), which latter term in practice means the tenth of the month following. While some wholesale hardware houses appear to insist upon a strict observance of discount terms, others are more liberal in this respect and permit several additional days to be taken without protest.

The terms 2/10/30 generally apply also to shelf-hardware, except that on these goods some wholesalers quote terms of 2/15/30. Where, moreover, the retailer lives at a considerable distance from the sup-

ply house, it is not unusual for the latter to permit the cash discount to be reckoned from the arrival of the goods—which in some cases and under certain circumstances may mean an interval of one month or more from date of invoice.

The class of hardware supplies described as "auto accessories," is sold largely to proprietors of garages and repair shops. The usual credit terms are quoted on these goods, but since not a few of the persons engaged in the business are financially irresponsible, and since the business itself is unstable, certain precautions are often taken. Thus, it is frequently deemed expedient to demand an advance payment of as high as seventy-five per cent of the amount of invoice. This, however, is a matter of local or individual conditions rather than one affecting credit terms in normal transactions.

9. *Customary credit practice in the boot and shoe business.*—The terms upon which footwear is sold to the retailer are almost uniformly 2/10/60—sixty days net, two per cent off for cash in ten days. In practice, however, it usually means two per cent for payment on or before the tenth of the month following. As a variant of these terms, one per cent for cash in thirty days, sixty days net (1/30/60) is sometimes quoted.

The foregoing terms apply also to "findings" or shoe store supplies, such as shoe strings, buttons, shoe blacking, shoe trees, etc.

The shoe trade is subject to seasonal influence, the

heaviest demand occurring just before the Christmas and the Easter holidays. At these seasons it is often necessary for the manufacturer or jobber to extend the dealer's usual credit limit, tho the credit terms themselves are not thereby affected. Moreover, the seasonal demand frequently compels a manufacturer to fill orders a considerable length of time in advance of the stipulated date of delivery. Orders for fall deliveries, for example, are usually taken in the spring; and as these orders accumulate, it is often found necessary to begin making up the goods early, so that the activities of the factory may proceed uniformly and that its facilities may not be unduly taxed by an avalanche of orders to be filled simultaneously. Inasmuch as storage, insurance, etc., on finished goods add materially to their cost, it is a common practice for the manufacturer to select from among his customers those that are financially strong and well established in business, and ship them their season's goods in advance, while of course billing the goods at the date called for in the order. In this way the customer is given the free use of the goods for two, three, or perhaps four months, while at the same time expense is saved at the shipper's end.

It is generally well understood, however, that no agreement exists between the parties to ship in advance, the manufacturer reserving to himself the right to do so or not, according to his own convenience. In practice it generally means that the same dealers receive the same privilege year after year.

Rubber shoes and boots are commonly marketed by the manufacturers thru shoe jobbers. The latter, in turn, sell the goods to retail dealers on a December 1 dating, with delivery from April 1. A discount of one per cent per month is given for prepayment. To illustrate: let us say that a shipment of rubber shoes is made on April 1. According to the terms of sale the goods are billed as of December 1—eight months hence. If now the dealer, instead of withholding payment until the latter date, pays the bill at once, he is entitled to deduct a discount of eight per cent from the amount of invoice. If he waits until May 1, he may deduct seven per cent, June, six per cent and so on until on December 1, if he waits that long, he pays the amount without any deduction.

During that part of the year that lies between December 1 and April 1, rubber goods are sold on terms of thirty days net, or one per cent cash discount.

10. *Men's and boys' suits.*—Ready-made suits of the better grade are usually sold to the retailer on a sixty days' dating at seven per cent off for cash in ten days thereafter (7/10/60), or four months net. Cheaper grades are sold on a sixty to ninety days' dating net.

Season's dating in this line is May 10 for Spring term and November 10 for Fall term. Deliveries for the Spring term usually begin in February, and for the Fall term in July. A common quotation of terms in this line is therefore 7/10 season's dating.

Some manufacturers of men's clothing quote two

per cent in ten days, thirty days net, which in other cases is varied to read 3/10/30.

Cloaks and suits of the better grades are sold on terms of 7/10/60 (seven per cent in seventy days) which, when payment is "anticipated," equals eight per cent in ten days. On cheaper grades of goods the terms are usually 2/10/60 or 3/10 net.

11. *Customary credit terms in the lumber business.* —The business of lumber manufacturing and selling is, as might be expected, highly competitive, since such operations are scattered over the entire country from east to west and from north to south. Many associations of lumber manufacturers and dealers have been formed, and much has been done by these associations to foster the interest of the lumber trade. Uniformity of grading, dissemination of information relating to production and marketing of the product, etc., are the chief objects sought by such associations.

The National Wholesale Lumber Dealers' Association has adopted a uniform schedule of credit terms, of which the following constitutes the chief part:

> Settlement to be made promptly on receipt of each car. Freight net cash. Balance by note at sixty days from date of invoice or less 1½ per cent discount for cash, if paid within fifteen days from invoice; or 1 per cent for cash if paid within thirty days from date of invoice. No discounts allowed after thirty days. If car is not received within the above discount time, and discount is desired, prepayment on account will not be held as acceptance of the shipment, and the right to make corrections and complaints will not be

forfeited thereby. In making delivery to prices, cost of goods delivered at destination is guaranteed, but not against delay in transit. Claims for count or quality must be reported as soon as car is unloaded and tally proven. No claims allowed if not reported within ten days after unloading.

A majority of the accounts in the lumber business are settled by notes, tho the date of settlement is frequently made ninety days instead of sixty, as stipulated by the terms of the National Wholesale Lumber Dealers' Association. At times, the note is dated from the arrival and inspection of the goods instead of from date of invoice, which frequently adds considerably to the length of the credit terms. Credit terms are the same for both hardwood and softwood.

12. *Customary credit terms in the furniture business.*—The furniture business is peculiar in this respect in that it is grouped around half a dozen centers where manufacturers' product is collected and where retailers gather to inspect the season's offerings. Exhibitions are held twice a year at intervals of six months at different points. Salesmen for wholesale dealers cannot carry "samples" but only photographs and drawings. These substitutes are unreliable as a means of determining the finish and workmanship of the articles, so that buyers find it necessary to visit the furniture centers at the season's opening and inspect the goods themselves. The illustrations subsequently used by the salesmen on their visits serve chiefly as reminders of what has already been examined at the exhibition.

The credit terms usually quoted by wholesale furniture dealers are 2/10/30—net thirty days, two per cent off for cash in ten days from date of invoice, or as is frequently the case, 2/10/60. It is stated on good authority that while these terms are almost uniformly quoted, they are not always strictly observed in practice, and that competition is frequently made the excuse for a considerable deviation from regular terms. Lack of cooperation among wholesalers is generally blamed for the absence of uniformity in the credit practice within the furniture trade.

REVIEW

How do trade customs and merchandising practice affect the limits of credit granted in a given line?

Why should turnover serve as a guide in judging a credit risk?

What is the relation between credit terms and seasonal lines?

What are the factors in staple lines that determine credit terms?

CHAPTER VI

SOURCES OF CREDIT INFORMATION

1. *Importance of complete information.*—If the credit-giver were always in possession of all the facts that bear upon the credit-seeker's condition, he would make few errors in estimating the latter's credit title. It is because the information at hand is often incomplete and at times actually misleading that credit frequently is granted to a person, firm or corporation not rightly entitled thereto. It follows that the more complete and specific such information is, the less likelihood is there of making mistakes. The capable credit man neglects no opportunity to inform himself as fully as possible regarding the credit-seeker's actual condition, financial and otherwise, as far as this relates to his credit title.

The value of the credit information obtained must of course always be considered in connection with the sources from which it comes. Accordingly, what the credit-seeker says about himself must be viewed in a somewhat different light from that in which the report of an impartial third party is regarded. In the former case, there is always reason to believe that the information will reflect a too optimistic view of the credit-seeker's condition. It is hardly to be ex-

pected, of course, that a merchant who seeks credit favors should of his own accord furnish information about himself that might defeat his immediate object. Under the circumstances, it will not be surprising if certain facts are withheld or certain assets given a valuation somewhat in excess of their current market value. Due allowance must be made for this tendency.

2. *Overestimating the value of references.*—For the same reason it is practically certain that a person or house given as reference has been furnished ample cause for giving the credit-seeker a "clean bill of health" as a credit risk. Obviously, such reference would not have been given unless it were known in advance that the information would be favorable. It often happens that a scheming dealer in order to obtain a large amount of goods on credit establishes himself in the confidence of one or two well-known concerns, paying his bills promptly and otherwise acting the part of a model customer. Such concerns can only bear testimony to their satisfactory business relations with this customer. If the credit man is satisfied to go no further in his search for information, he may discover before long that he has been playing right into the hand of a clever swindler and that he has surrendered his firm's goods to one who has no intention whatever of paying for them.

3. *Five important sources of credit information.*—There are several important sources of credit information available to the credit man of a wholesale or

manufacturing house. These may be enumerated as follows:

1. Information furnished by the credit-seeker, usually in the form of a financial statement or, as it is sometimes called, a property statement.

2. Information furnished by mercantile agencies in the form of periodically revised rating books, weekly or monthly information sheets and special reports.

3. Information obtained from representatives of the selling house. (Salesmen's reports.)

4. Information obtained from houses selling the same trade, spoken of as exchange of ledger information or credit clearing.

5. Corroborative information obtained from local banks, resident attorneys and similar sources.

4. *Property statement; a basic consideration.*— There is one consideration in connection with the giving of credit that deserves to be constantly kept in view, namely, that the wholesaler who extends credit to a retailer becomes in a certain sense the latter's partner. He places in the retailer's hands without receiving an immediate equivalent, valuable merchandise to be resold by the retailer to the ultimate consumer. The profits of both wholesaler and retailer are dependent upon such resale. Accordingly, the manufacturer or wholesaler is just as desirous of finding an outlet for his goods thru the retailer as the latter is to obtain possession of them for purposes of profit thru resale.

On account of this mutuality of interest the wholesaler has an undoubted right to demand the fullest information regarding the retailer's facilities for reselling his goods at a profit and regarding his ability and willingness to render payment to the wholesaler at the expiration of the credit period. The retailer, realizing that his profits depend upon his ability to obtain such goods on credit for resale, should be equally anxious to prove to his creditor in the most conclusive manner possible that he really may be intrusted with the latter's merchandise. In other words, the interests of both retailer and wholesaler lie in giving and receiving the fullest information touching the former's title to receive goods on credit for the purpose of resale. Therefore, whatever prevents this information from being freely given, retards to some extent the transfer of merchandise from wholesaler to consumer by way of the retailer.

On this account the property statement has been made a means of conveying information which will test the existence of credit title in the retailer, a printed form being usually submitted upon which the credit-seeker enters the information asked for.

5. *Growing importance of the property statement.* —In years gone by the property statement was usually requested with an apology and either refused or rendered with bad grace. It was regarded by many dealers as an unwarranted attempt at prying into their business, and was often resented as an implication of distrust, if not as a personal insult. To-

day, modern ideas have made men understand that business confidence does not thrive in the dark and that credit, to be free and untrammeled, requires that the fullest light be admitted to the conditions which surround credit transactions.

This view of the matter has acquired increased emphasis by reason of the smaller profit margin upon which business is being done today. In most lines of business competition has driven prices down to a point where a few bad credits might wipe out the larger part of a season's profit. On that account credits are being surrounded with greater safeguards than formerly, since every precaution must be taken to insure the payment of all bills at maturity. Hence, in their demand for a property statement, wholesalers are embodying questions which probe more deeply into the retailer's status than was formerly the case.

6. *Periodical revision of signed statements.*—With regard to the frequency with which signed property statements should be demanded there is much difference of opinion. For fear of offending a customer who may be opposed to giving signed statements, some credit men ask for property statements only when circumstances of a grave or suspicious nature make such requests imperative. Others ask for signed statements only in the case of a new account, while still others request one from each of their customers new or old, at stated intervals—once a year and in some cases even oftener.

One nationally known manufacturer makes it a rule to obtain a financial statement from every new customer, either direct or thru the commercial agencies. The absence of such statement, he says, is viewed with suspicion. Another prominent manufacturer insists upon receiving a signed statement if the customer's credit title is in the least obscured. A similar attitude is taken by a large shoe company in St. Louis. whose credit department demands a statement whenever circumstances make such a demand expedient.

Certain other prominent houses, among which is a big food products concern in Pittsburgh, do not usually demand a statement of a new customer, nor do they, as a rule, request periodically revised statements of old customers. Such houses usually have branches thruout the country, in each of which there is a credit department. This company has about thirty such branch houses, each with its own credit department.

In view, however, of what was said about the relation between the parties to a credit transaction, it appears that requests for initial and periodically revised statements are fully justified, unless the information sought is obtained in other ways.

Moreover, such periodical "looking the facts in the face," as the frequent revision of his property statement involves, is not a bad thing for the debtor himself. It keeps him hewing close to the line, promotes economy and efficiency, and checks the tendency to overbuying. The value of a signed property

statement is further increased by the fact that the court will hold its maker accountable for any wilful misrepresentation of the facts as stated therein. When the statement is issued for the purpose of obtaining goods on credit, such misrepresentation will be construed as an attempt to obtain goods under false pretenses, and the maker will be liable to punishment for the offense.

7. *Common forms of property statements.*—The forms of property statements here shown are among those most generally approved by commercial houses. It is not necessary to comment at length upon these forms or to discuss in detail the special questions they raise. A study of them will show in what particular facts the credit departments of a mercantile house are interested, and in what special form such information is most conveniently presented. It will be noted that the form here given is for a corporation.

The questions asked in the corporation statement show both in their number and character how much more intricate is the organization of capital in the corporate form.

The type given as an example for commercial houses was selected from a series of forms recommended by the National Association of Credit Men The items appearing upon these forms are substantially alike, tho their arrangement differs somewhat. Note particularly the paragraphs describing the reciprocal value of a signed statement. They show that the Association of Credit Men seeks to educate

Property Statement Blank

RECOMMENDED AND INDORSED BY THE NATIONAL ASSOCIATION OF CREDIT MEN

THE RECIPROCAL VALUE OF A SIGNED STATEMENT

Good credit in the markets of the world enables every merchant to add to his ability to do business. It gives him the use of enlarged capital, thus enabling him to carry a more complete stock, increase his sales, and magnify his profits.

Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets, and in harmony with conditions which create and maintain it. *A merchant's capital is the sum of his net available resources, plus his credit.* The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a perfect right to complete information of the debtor's condition at all times.

Credit is given a merchant because of the confidence reposed in him. Requesting a statement when credit is asked is not a reflection on one's character, honesty, or business ability, but is done to secure information to enable business to be conducted intelligently.

When a statement is made it should be absolutely correct. To make it so necessitates the taking of at least an annual inventory and the keeping of an accurate set of books. Statement giving, therefore, will tend to make a debtor a better buyer, because more familiar with his stock, more careful in giving credit, more conservative in incurring debt, and will result in a better knowledge of his business generally.

A merchant who desires to serve his own best interests should recognize that his most valuable possession, apart from his actual assets, is a sound, substantial and unquestioned reputation as a credit risk, and that, under the prevailing conditions and demands of business, the most effective, and eminently the best way to prove his basis for credit, is to be willing to submit a statement of his financial condition.

NOTE: The above estimate of the value of a statement to both giver and receiver is the embodiment of the thoughts and experiences of scores of the leading credit men of the United States who are members of the National Association of Credit Men and who thus desire publicity given to their views in order that there may be the largest benefits to both retailer and wholesaler.

the commercial world to recognize and conform to the standards demanded by a sound credit policy.

8. *Mercantile Agency Service.*—The two large credit institutions known as Dun's and Bradstreet's Mercantile Agencies serve thru branch offices and

Form IV.

PROPERTY STATEMENT BLANK [1]

RECOMMENDED AND ENDORSED BY THE NATIONAL ASSOCIATION OF CREDIT MEN

"Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets The giver of credit is a contributor of capital and becomes, in a certain sense, a partner of the debtor and, as such, has a perfect right to complete information of the debtor's condition at all times."

To RICH, MANN & CO . New York: Dated 191

For the purpose of obtaining credit for goods to be sold me or us by you, or for any extension granted me or us on my or our account with you, the following is given you as a true statement of my or our assets and liabilities and general financial condition. I or we agree to and will notify you immediately in writing of any materially unfavorable change in my or our financial condition, and in the absence of such notice, or of a new and full written statement, this may be considered as a continuing statement and substantially correct.

BUSINESS ASSETS	Dols.	Cts.	BUSINESS LIABILITIES	Dols.	Cts.
Cash value of Merchandise on hand			Owe for Merchandise, not due		
Store Furniture and Fixtures			Owe for Merchandise, past due		
Cash in hand			Owe Notes for Merchandise		
Cash in bank			Owe Banks		
Accounts good and collectible			Owe Relatives and Friends		
Notes good and collectible			Owe Taxes		
Store, Building and Lots, $ — } Equity			Owe Rent		
Mortgaged, $ — }			Total Business Liabilities		
Other personal property			Net Worth in Business		
			Total		
Total Business Assets			If any of above liabilities are secured, state particulars in proper place below.		

OUTSIDE ASSETS	Dols.	Cts.
Total Real Estate owned		
Less exempt portions		
Total Real Estate not exempt		
Encumbrance on Real Estate not exempt		
Net Equity in Real Estate not exempt		
Other Property not exempt		
Total Outside Property		
Debts not enumerated above		
Net Outside Assets		
Net Worth in Business		
Total Net Worth in and out of Business		

Full Given and Surname of Each Partner	Age	Married	Liability as Endorser or Bondsman

Nature of Business

Insurance on Merchandise $

Insurance on Real Estate $

Insurance on Furniture and Fixtures $

Insurance on Other Property $

Pay Rent on Store, per month $

Commenced Business Lease Expires

Bank with

Date of last Inventory

Ever burned out

Keep following Books of Account

Included in Liabilities in Above Statement:

Mortgage on Merchandise . . . . . $ . . . .
Mortgage on Furniture and Fixtures $ . . . .
Mortgage on Horses and Wagons . $ . . . .
Mortgages on Other Personal Property $ . . . .
What proportion of Sales is on Credit $ . . . .

Suits Pending . . . . . $ . .
Judgments . . . . . $ . .
Judgment Notes . . . . . $ . .
Mechanics' Liens . . . . . $ . .
Amount of Sales Last year $ . .

Merchandise consists of

Dry Goods . . . $ . .
Notions . . . . $ . .
Clothing . . . . $ . .
Boots and Shoes $ . .
Hats and Caps . $ . .
Groceries . . . $ . .
Crockery . . . $ . .
Hardware. . . . $ . .
. . . . . $ . .
Total . . . $ . .

REMARKS—Give details and explanations of questions not fully answered above . . . . . .

If you have pledged or transferred outstanding accounts or property remaining under your control, state amount thereof and amount received, or to be received, on account of such pledge or transfer . . . . . .

The above statement, both printed and written has been carefully read by the undersigned, and is a full and correct statement of my or our financial condition as of . . . . . , 191 . . . .

Firm Signature . . . . . .

Town . . . . . State . . . . . By . . . . . a member of the firm

On the reverse side of this sheet is given a complete list of houses I or we deal with, and amount owing each one; also a description of all real estate owned.

Standard Form D.

1 Sent by a commercial house to be filled out by an individual or partnership firm.

Form V.

PROPERTY STATEMENT BLANK [1]

RECOMMENDED AND ENDORSED BY THE NATIONAL ASSOCIATION OF CREDIT MEN

"Large assets are not always necessary to the creation of credit: what is most desirable is, that credit be in relative proportion to the actual assets. The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a perfect right to complete information of the debtor's condition at all times."

To RICH, MANN & CO., New York:

For the purpose of obtaining credit now and hereafter for goods purchased, we herewith submit to you the following statement of our resources and liabilities, and will immediately notify you of any material change in our financial condition.

In consideration of your granting credit to the undersigned, we agree that in case of our failure or insolvency, or in case we shall make any assignment for the benefit of creditors, bill of sale, mortgage, or other transfer of our property, or shall have our stock or plant attached, receiver appointed, or should any judgment be entered against us, then all and every of the claims which you have against us shall at your option become immediately due and payable, even though the term of credit has not expired. All goods hereafter purchased from you shall be taken to be purchased subject to the foregoing conditions as a part of the terms of sale.

ACTIVE BUSINESS ASSETS	Dollars	Cts.
Cash value of merchandise on hand		
If manufacting, raw material, $---finished, $----unfinished, $----		
Notes and accounts, cash value		
Cash in hand		
Cash in bank		
Bills or accounts receivable, due from officers		
Patents and patterns		
Fixtures and machinery		
Total real estate, cash value, $----		
Total encumbrances on real estate $----		
Equity		
Total Active Business Assets		

BUSINESS LIABILITIES	Dollars	Cts.
Owe for merchandise open acct., of which $---- is past due		
Owe for notes for merchandise		
Owe banks		
Owe for bills for paper sold		
Owe others for borrowed money		
Owe taxes and rent		
Mortgages on fixtures and machinery		
Total Business Liabilities		
Net worth in Business		

Contingent Liability { Accommodation Indorsements .. Indorsed Bills Receivable and Outstanding ....

Authorized Capital ....
Subscribed...Paid in...
How paid in: Cash, $..
Other property .....
Incorporated in what State and under what General Laws or Special Act?.....
.....
Nature of business?....
Date of charter?.....
Suits pending, and of what nature? .....
.....
Are any merchandise creditors secured in any way?.....
Amount of annual business .....
Annual expenses.....
Annual dividends....
When was last dividend declared .....
Rate..... Insurance carried on merchandise ..... On fixtures and machinery ..... On real estate .....
Regular time of taking inventory .....
Keep bank account with .....
.....
Keep the following books of account .....
.....
If you have pledged or transferred outstanding accounts or property remaining under your control, state amount thereof and amount received, or to be received, on account of such pledge or transfer .....
.....
REMARKS: .....
.....
.....

OFFICERS

	Name in Full	Address
President		
Vice-Prest.		
Secretary		
Treasurer		

DIRECTORS

The above statement, both printed and written, has been carefully read by the undersigned, and is a full and correct statement of our financial condition as of ..... 191 ....

Dated ..... 191 .. Corporation Signature .....

Town ..... State ..... By .....

On the reverse side of this sheet is given a list of houses we deal with

1 Sent by commercial house to be filled out by a corporation.

Standard Form G.

their connections virtually every part of the business world.

The organization by means of which the mercantile agencies collect their information is one that touches every person engaged in business in the United States and Canada. Offices are located in all the important cities in the country district. These offices constitute central points at which the information sought by the agency is conveniently collected.

In large cities this work is specialized by assigning to certain reporters certain lines of trade. Since each important line has its own special reporter the agency is in a position to keep well informed of current happenings, and is accordingly able to disseminate among its subscribers prompt and reliable information about the various lines of trade within the cities covered.

Territory outside the larger cities is divided into districts, to each of which a reporter is assigned. In such districts the local reporter investigates all the lines of trade found therein. As these reporters cover the same territories year after year, they become well acquainted with local trade conditions and have many opportunities to study the business of each individual concern. Like the newspaper reporter, the commercial agency reporter has a nose for news—that is, for such news as is of interest to creditor houses. Any rumor affecting the credit of a local dealer is promptly investigated and the result is reported to the nearest district office.

Each of the large and independently operated offices has sub-offices in the smaller cities. The number of such sub-offices is governed by the size of the territory and the volume of business ordinarily transacted, some district offices having as many as eight or more sub-offices.

In territories where reporters make only periodical visits, the agencies depend upon local commercial attorneys, postmasters or reliable merchants for information regarding sudden changes or developments that may occur in the standing of local merchants.

9. *Dun's and Bradstreet's rating books.*—The mercantile agency distributes to its customers or subscribers the credit information which it gathers in two forms. One way in which this information is made accessible to merchants and manufacturers is thru periodically issued rating books. These books, which are revised quarterly, contain the name and address of practically every person engaged in business in the United States and Canada. Two ratings are given—a capital rating and a credit rating. The capital rating is intended to show how much capital is invested in the business, tho it is generally understood to mean "the commercial value of the par value of the assets which the firm rated may be considered to have in its business, all things regarding the terms and the business being taken into consideration." The credit rating expresses the agency's opinion with regard to the degree of confidence to which the firm is entitled. In order to determine the latter, the char-

acter and ability of the dealer or firm are considered in connection with the amount of capital invested in the business.

It is not to be expected, of course, that these ratings should in every case be in perfect accord with actual conditions. It must be remembered that the agency has no means of compelling the dealer to give out information about himself or about his business. If he is unwilling to furnish such information, the agency is compelled to gather it from other sources as best it may. Moreover, inasmuch as about three thousand changes occur daily in the credit ratings of the country, it is readily seen that the rating book must contain a large number of errors even on the very day of its publication. For all that, however, the ratings given by the large commercial agencies are, on the whole, remarkably exact.

10. *Special credit reports.*—The mercantile agencies usually seek to obtain from every dealer a property statement or its equivalent as a basis for the information to be kept in their files, adding to the information thus obtained such other data as its local reporters may from time to time obtain. From this information special reports are prepared for subscribers at their request. These reports include a record of the dealer's business and personal character, his wealth in and out of business, his debts, his associations and his reputation. They contain, also, a description of the business itself—capital, debts, outstanding accounts, the volume of annual business and

frequently the names of the chief creditors. In a concluding statement, the agency offers its judgment with regard to the worth, credit limit and other factors bearing upon the credit risk involved.

As a general rule, the information on file in the agency's office is revised only twice a year. But since many things may happen within six months to change materially the dealer's financial condition, the cautious credit man will usually seek corroborative evidence regarding the customer's credit title before acting upon the information contained in the agency report.

11. *Cost of the agency service.*—The cost of the mercantile agency service (Dun's or Bradstreet's) varies somewhat according to the subscriber's territory, but is approximately $150 for two half-yearly rating books and one hundred special reports. Quarterly rating books, instead of half-yearly, may be had at a correspondingly extra charge. Additional special reports are furnished by the agencies at an average rate of fifty cents each.

12. *Special trade agencies.*—In addition to these two large general agencies, there are now a number of special agencies operating within a single trade or within a few allied trades. It is claimed for these special agencies that they are better able to serve the needs of the trades to which they cater than are the larger agencies, which attempt to cover all lines of trade. This advantage is denied by the advocates of the general agencies, who maintain that the latter, by

reason of their wider contact with business and with trade conditions in general, obtain information that is inaccessible to the smaller organizations. Whether or not this claim is justified, the continued existence and apparent growth of the trade-agency idea justifies the belief that this form of service possesses definite merit.

Like the general agencies, these special agencies usually publish quarterly or half-yearly rating books, issue monthly or weekly information sheets embodying all recent trade information and furnish special credit reports upon request. As a rule, the special trade agencies employ a finer division of capital and credit ratings than do the general agencies, frequently including a third or "pay" rating, the object of which is to avoid, if possible, mere generalizations with regard to the person or firm under investigation.

The special credit agencies listed in the following well-known lines are representative of this type in organization and service:

Iron and Steel Board of Trade—New York City
National Jeweller's Board of Trade—New York City
Furniture Commercial Agency Company—New York City
Leather Mercantile Agency—Boston
Consolidated Building Trades Association—New York City

13. *Salesman as a credit reporter.*—Among the earliest sources of credit information about a retail merchant was the report furnished by the salesman who visited him in his store and sold him a bill of

goods. At first glance it may seem natural to combine in one person the offices of salesman and credit man. In practice this is usually undesirable except to the degree that he may corroborate information already procured. Between the two functions there is often a wide gulf. The self-interest of the salesman intent upon securing the order frequently blinds him to the customer's shortcomings and thus places a distance between the firm and the customer which the resources of the credit department are called upon to span.

Someone has said that of the four chief factors which enter a salesman's considerations, he himself comes first, the credit man fourth, and between these two the customer and the house. While it may be doing injustice to the salesman to accept this statement as invariably true, it is nevertheless a matter of observation that in a large number of instances the salesman's judgment is not to be fully trusted on questions relating to the customer's credit title. It is equally true, however, that the credit man may obtain thru the salesman information of a certain kind not easily obtained from other sources and that such information is a valuable supplement to the reports received thru the commercial agencies and other channels.

The information that may rightly be demanded of the salesman he can easily supply from his own observation and experience. So long as the salesman is not required to ask questions which would embar-

rass both him and the customer, it is perfectly proper to make use of his services in the compilation of credit data. The following form has been used in this connection, the salesman filling out and attaching it to his order sheet.

Firm name ..... Address .....
Date ..... Salesman .....

In General

Business good? Growing? Competition?

In Particular

Store neat? Well located? Any advertising signs?
Stock kept in good order? Well displayed? Well stocked or low?
Clerks well trained or incompetent? Kept busy?
Proprietor a good business man? Social standing?
Drink? Gamble? Other firms bought from?
.....
.....

Whenever conditions seem to warrant it, the credit man may ask for a revised report on the same form, thus keeping his information up to date.

Despite the denial of some credit men, there is no doubt that an observing salesman is in a position to furnish credit information of distinct value. He has the very important advantage of observing the customer in his business surroundings and is thereby enabled to draw first hand conclusions, a privilege that is denied the distant credit man. It is more than probable that many credit men fail to avail them-

selves as fully as they might of the assistance which the sales department is able in this way to render—a lack of sympathetic understanding often blocking the way.

For the existence of such a condition the credit man is as a rule chiefly to blame. It is a mistake to demand of the salesman that he go prying into the affairs of the customer as tho he were a mercantile agency reporter or a detective in quest of damaging evidence. The salesman's mission is primarily to sell goods. Any additional function which may conflict with sales is obviously distasteful to him and will not ordinarily be well performed.

There is nothing objectionable, however, in requesting the salesman to keep his eyes and ears open while in the customer's store and to gather all the information he can about the character and volume of the merchant's trade, his sales methods or his store premises. The salesman will often be able, by a casual question or two directed to the hotel clerk, the liveryman or a salesman for another house, to learn a good deal about the merchant's social standing in the community. All information of that sort should be jotted down and forwarded to the credit man without delay.

14. *Traveling credit man.*—The practice of employing traveling credit representatives arose from the necessity on the part of large houses to obtain direct information about certain classes of accounts which because of their number and magnitude fre-

quently become not only heavy but doubtful risks. This method of gathering credit information is necessarily expensive, but the extent and complexity of modern wholesale business seem to demand it more and more, since it is not usually possible for the credit manager to visit far-away customers except in cases of unusual importance.

The function of the traveling credit man may be said to be the complement of that of the traveling salesman. The responsibilities of the position of a traveling credit man call for a man of experience—one who can analyze critically the customer's books, examine his stocks, and if necessary make use of the information obtained from banks, local attorneys and commercial agencies. The visit of such a man is the best substitute for that of the credit manager himself for he brings to the investigation a knowledge of both sides of the situation since he is well acquainted with the details of the local business as well as with the policies of the credit department of his house. He is able to view any disputed point from the standpoint of both the customer and his house and can suggest mutually satisfactory settlement. His chief business is tactfully to learn the actual conditions of the dealer. Despite his best efforts, the traveling credit man finds that he is often regarded with mixed feelings by those on whom he calls, as his visits are likely to carry the suggestion that a doubt exists at headquarters with regard to the dealer's financial soundness.

For all that, a traveling credit man of the right

caliber is frequently able to give excellent advice to the small dealer and to instruct him in principles of good merchandising. He often finds a dealer who is unsystematic and ignorant of many things that he ought to know relating to ordinary principles of successful merchandising. In fact some of these dealers are not capable of managing their business unaided in such a way as to be safe credit risks. The traveling credit representative by tactfully instructing and strengthening the ignorant or weak merchant not only increases the latter's chances of success, but makes him a better and a safer customer.

The traveling credit representative is often able to serve his house still further by promoting harmony and cooperation between the departments of sales and credits, eliminating by his visits the causes of friction that sometimes arise between these two.

As evidence of the character and extent of credit information obtained by such traveling representatives, the report form shown on the following page is of interest. To obtain the desired information calls for much close questioning of the subjects of the report; but in the hands of a capable and tactful representative of the credit department the examination need not be either long or painful.

15. *Local attorney as credit reporter.*—In every city and town of any consequence there are to be found attorneys who specialize in commercial business or who at least have departments for the handling of such business. These attorneys assist in collect-

.....BRANCH 191....

NOTE: Traveler must attach Merchant's Bill Head, Letter Head or Card.

No.....

Name of Firm.....
Address ..... Town ..... State .....
(Street Address required in towns of 5000 or more population)
Full Name of Partners or owners. If a corporation, position held (Pres., Sec'y., etc.)
Name..... Age..... Married?.....
Name..... Age..... Married?.....
Name..... Age..... Married?.....
Name..... Age..... Married?.....
Kind of business..... How long in business at this location?..... Successor to.....
Give former address if ever in business before.....
What kind of business?..... How long in that business?.....
From..... to.....
Why did he discontinue?.....
If failed, what settlement was made with creditors?.....
If never before in business, what has been his occupation, and by whom employed?
.....
Does he give business his personal attention?.....Is his business growing?.....
Is he active?.....Is he attentive to business?.....Is he experienced?.....
What are local opinions as to his habits?.....
What do you consider are his chances for success?.....
What credit limit do you advise?.....
Value of real estate $.....Insured for $.....
Mortgage on real estate $.....Net value of real estate $.....
In whose name is title to real estate held?.....
Value of stock $.....Insured for $.....
Value of fixtures $.....Insured for $.....
Chattel mortgage $.....No. of clerks?.....No. of wagons?.....
Monthly sales $.....Monthly expenses (Including Rent) $.....
Sell for cash or on credit?.....Appearance of stock and store?.....
Character of neighborhood, viz., poor, medium, or high-class?.....
Competition keen?.....How many chain-stores in vicinity?.....
Banks with .....

Give References and your Personal Opinion on other side of this sheet.

ing claims against local debtors for the benefit of out-of-town creditors. They undertake to bring suit in court when circumstances demand such a course, and give attention to claims in bankruptcies, etc., as described more fully in another chapter.

Such attorneys are usually in a position to render valuable service to the distant credit man. Their profession brings them in close contact with the business and the business men of their localities. Their training qualifies them for judging accurately local business conditions. Moreover, their relation to the community enables them to use their information with-

out thereby violating any trade confidence and without injury to their own business interests.

In cities large enough to offer a considerable amount of commercial business, law firms have found this class of business distinctly profitable and have gone to considerable expense and trouble in collecting and filing information relating to the credit standing of local merchants. Frequently the credit man obtains very valuable information from such sources.

16. *Law lists and free attorney reports.*—A number of law lists or attorney directories are published in which attorneys seeking commercial business have their names and addresses entered. For "representation" of the list in their town or city the attorneys pay the publishers a certain yearly fee, the amount of this fee depending upon the size and business importance of their respective localities.

These law lists are placed in the hands of wholesale houses, collection agencies, and others who may have out-of-town claims to collect. The publishers generally guarantee the prompt remittance of all moneys collected by the attorneys listed in their publications. For the purpose of securing a large use of their lists by those who have profitable business to send to attorneys, publishers generally demand of the latter that they furnish upon request free credit reports on merchants in their localities. Report blanks are provided for the use of the subscribers and sold to them at a certain price per hundred, the understanding being that in return for such free reports the

attorney is to receive whatever collection business the forwarder may have in the attorney's locality.

This plan is by no means infallible; it is usually satisfactory in direct proportion to the energy and interest displayed by both attorney and forwarder. The free-report system has been greatly abused. Merchants have often been found to send under cover of two or three law lists inquiries to several attorneys in the same town, promising in return to each attorney whatever collection business they might subsequently have in that locality. At times two or more attorneys in a town on comparing notes, would discover that they were being "worked" by some ambitious credit man who sought to obtain the largest possible amount of free information about a local dealer. These abuses eventually became so flagrant that many attorneys refused to continue the free-report service. In many counties bar associations adopted a schedule of fixed rates for all legal services performed by their members, these rates also covering the furnishing of credit reports. Owing to the growing antagonism with which commercial attorneys generally view what they term the "free report evil," the use of these reports is less extensive than formerly.

It is not to be denied that an attorney report, if carefully prepared, contains information not easily obtained from any other source. As a sample of the character and amount of information sought by means of a free report a form commonly used for that purpose is shown in these pages. As may be judged

from the nature of the questions, the preparation of the report requires the expenditure of considerable time and labor. It is easily understood that the attorney who receives in his morning's mail from six to twelve such inquiries is not likely to look upon the free-report system with special favor. Accordingly, in most instances only such questions are answered as may be answered offhand. Frequently indeed the inquiry goes into the wastebasket unanswered.

SAMPLE FORM OF "FREE" REPORT

Dear Sir:

Will you please report in confidence as to character, responsibility, etc., of .....

Yours very truly,

.....

M'd's'e .....
Realty .....
Cash .....
Other means .....
Incumbrance on realty .....
Other indebtedness .....
Character .....
Habits .....
Business ability .....
Do you regard safe for .....on.....time?
If not paid can you collect? .....
Ever fail? .....
Remarks .....
.....
.....

For the purpose of comparison, another form of attorney report is presented, with which the sender incloses one dollar as compensation for the attorney's services. It is easy enough to determine in advance which of these reports will be of greater value when returned to the inquirer.

SAMPLE FORM OF "PAID" REPORT

PREPARED AT THE INSTANCE OF THE NATIONAL ASSOCIATION OF CREDIT MEN

Dear Sir:

Your name appears on our list as having represented us, or as being ready to look after our interests should occasion arise requiring your services.

Inclosed, therefore, please find $1.00, for which kindly send us confidentially as complete a report as possible on this blank on.....
....., especially answering the various questions specified. Delayed reports are of no use, therefore be prompt, please. Do not disclose our name as inquiring. File our name as being interested in above business and advise us at once of any change affecting his or their financial standing.

Yours truly,

.....

Name ..... Town .....
County ..... State .....
Full names of ..... Nationality?.....Age?.....Married?.....
All partners ..... Nationality?.....Age?.....Married?.....
..... Nationality?.....Age?.....Married?.....
How long in present business?..... What amount of capital invested? ..... Ever failed?..... When?.....
How did they settle? .....Ever been sued?.....Ever asked extension? .....Any evidence of overdue indebtedness?.....
If so, of what kind and amount? .....Reputation, good, fair or bad for ability? ..... Honesty?.....Promptness?.....
Is he doing a good business? ..... Location relative to business center? ..... Is stock in good condition? ..... Your estimate of amount of stock carried? $..... Is it insured?.....

Value of real estate above exemptions and incumbrances .....$.....	Of whom does he buy goods, if you know? .....
Value of other assets ....$.....	.....
Your estimate total net worth above all debts, exemptions and incumbrances .....$.....	.....

Remarks

Any answers which cannot be made in above spaces kindly indicate by some mark and amplify here .....
.....
.....

Opinions differ among the larger houses of the country regarding the value of attorney reports. Some firms make extensive use of such reports, others use them only occasionally.

17. *Banks as sources of credit information.*—Supplementing the local attorney as a source of credit information, the local bank renders a similar service of value to the business world. These institutions in the course of their daily business acquire a wealth of reliable information touching the financial condition, the business and social standing of local merchants and of other business men in their town.

The bank's attitude toward the commercial world differs somewhat from that of the commercial attorney, inasmuch as the bank may have an interest in the affairs of a local merchant just as great as that of the distant wholesaler who is applying for information. If the merchant in question is a borrower at the bank, the bank is necessarily anxious that nothing should take place that might endanger the borrower's ability to repay his loan.

It should always be remembered that banks are not usually so well acquainted with a local dealer's condition as is the latter's jobber, since the banks, owing to the greater caution generally exercised by them, usually demand security for their loans, while the jobber or merchandise creditor exacts no security. Accordingly, the jobbers or wholesalers are compelled to exercise closer supervision over the account, hence their experience with a debtor is likely to be of

greater value as affording more dependable credit information than the opinion of the bank which holds the debtor's security for its loan. It should be explained however that the fault often lies not with the bank but with the inquirer, who does not tell frankly exactly what he wants. Banks as a rule are willing to cooperate when they know what information is really needed.

Often the request merely asks the question "Is he good?" The answer depends largely on how much is involved. If the inquirer would ask if the customer were good for $100 to $1000, or $100,000 the bank has some basis to go on. It is often quite possible for the bank's credit man to recommend a dealer for $1000, that he would not care to recommend for $2000 or $5000.

Because this point is so often overlooked by the inquirer, many large houses rarely make use of banks as sources of credit information. Others do so only under certain circumstances, as when the customer himself gives the bank as reference. Still others are inclined, even under these conditions, to discount the value of the bank's report, unless, as expressed by one credit manager, "the information is secured for us by our own bank." The last statement carries its own suggestion, tho we do not maintain that the statement is in every sense fair to the banks.

Banks have been accused of undue delay in answering inquiries for credit information, and this delay has been advanced as an objection to the use of

banks in this capacity. We are inclined to think that this charge could not be uniformly sustained, since banking institutions as a rule are models of efficiency.

REVIEW

What may be said in favor of the financial statement as a basis for credit, and to what causes, may misleading information contained therein generally be attributed?

What is the nature of the information you would expect to obtain from the commercial agencies and the attorney?

In what respect does the work of the travelling credit representative differ from that of the travelling salesman with regard to the investigations of credit conditions?

What circumstances may be supposed to influence the bank in answering requests for credit information on a local merchant?

CHAPTER VII

COOPERATIVE METHODS IN CREDIT INVESTIGATION

1. *Credit cooperative methods.*—Within recent years, many wholesalers have come to feel that despite the excellence of the service usually rendered by the large mercantile agencies with their extensive organizations and with the ramifications of their investigating system there was a certain element lacking, namely a convenient way for creditors selling in the same market to exchange ledger experience. While the two large agencies and some of the special agencies in restricted fields endeavor to furnish a certain amount of trade experience, it was felt that their present plan of operation does not permit them in this respect to meet completely the need of the business world.

Accordingly, efforts have been made within trade lines to distribute information obtained from the ledger experience of the members of such trades, and various bureaus have been established for the purpose of facilitating such exchanges.

The purpose of an interchange system, as set forth by an officer of a leading agency, is to provide "an impartial medium between debtors and creditors and between creditors themselves, and to establish a sys-

tem whereby those who are interested in any accounts may freely and unreservedly interchange the facts contained in their ledgers, without the necessity of direct reference, each to the other; without divulging this information under their own name; and at all times receiving in exchange for items contributed by them the combined experiences of all the others interested in the account."

2. *Characteristics of ledger experience.*—As will be seen, this form of credit information differs materially from that supplied by the ordinary credit agency, for the interchange of ledger experience does not concern itself directly with antecedents, nor with the dealer's character and reputation. It does not even take into consideration the size of his capital. Such an interchange system takes account solely of the subject's recent purchases and payments. Thru information submitted by other members, an inquiring member may usually learn whether his customer has placed orders with other houses, how much he is owing on account, and whether he is meeting his payment obligations with due promptness.

In the judgment of experienced credit men, this form of information constitutes the most valuable basis of credit extension at present available to the manufacturer and the wholesale merchant. It is now pretty well recognized that the record of a dealer's purchases and payments, provided it is sufficiently complete, affords more material for intelligent credit analysis than the combined testimony of agency rat-

ings and reporters' opinions. Obviously, the value of such a system depends chiefly upon the extent to which the selling houses participate. At first, considerable difficulty was experienced in inducing merchants to participate in an exchange of ledger information. They were loath to give out information about their customers for fear this information might be used in some way to the detriment of themselves or their customers. Of late, a more enlightened view of the matter is being taken, and as a result this method of investigating credit risks is rapidly gaining favor.

RETAIN THIS FOR YOUR FILES

JAMESTOWN, N. Y.,.....191

M.....

.....

We give you below OUR EXPERIENCE with

Name .....

P. O. .....

PLEASE CONSIDER INFORMATION STRICTLY CONFIDENTIAL

Yours truly,

WHITE, GRAY & Co.,

FURNITURE MANUFACTURERS

		MANNER OF PAYMENT
Sold Since		
Terms	.....	Discounts
Highest Recent Credit $.....	.....	Prompt and satisfactory
Owing now { On Notes, $.....	.....	Slow but considered good
Owing now { On Open Account, $...	.....	Slow and unsatisfactory
Past Due.. { On Notes, $.....	.....	Pays C. O. D.
Past Due.. { On Open Account, $...	.....	Sell for cash only
First Order, $	.....	Account secured
Other Information	.....	Notes secured
.....	.....	Account closed for cause
.....	.....	Makes unjust claims
.....	.....	Collected by attorney

RETURN THIS TO US

JAMESTOWN, N. Y.,.....191

M.....

.....

Kindly give us below YOUR EXPERIENCE with

Name .....

P. O. .....

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,
WHITE, GRAY & Co.,
FURNITURE MANUFACTURERS

		MANNER OF PAYMENT
Sold Since		
Terms	.....	Discounts
Highest Recent Credit, $.....	.....	Prompt and satisfactory
Owing Now {On Open Account, $..	.....	Slow but considered good
Owing Now {On Notes, $.....	.....	Slow and unsatisfactory
Past Due.. {On Open Account, $..	.....	Pays C. O. D.
Past Due.. {On Notes, $.....	.....	Sell for cash only
First Order, $	.....	Account secured
Other Information	.....	Notes secured
.....	.....	Account closed for cause
.....	.....	Makes unjust claims
.....	.....	Collected by attorney

3. *Procedure in the exchange of ledger information.*—One form of such credit interchange is that which is carried on between dealers without the intermediary of a central bureau. The form shown on this and the preceding page has the approval and recommendation of the National Association of Credit Men and is one that is frequently used for this purpose.

The two blanks, as will be noted, are identical save for the lines at the top. The first is filled out by the inquiring member, who thereby shows his willingness to give information as well as to receive it. This in-

quiry, together with the second blank form, is thereupon sent to the house of which inquiry is to be made. The latter promptly enters upon the second blank and in the spaces provided therefor, the information in its possession and returns this form to the inquirer.

4. *Reciprocity a necessary element.*—Obviously such a system demands of each participant absolute fairness and constant readiness to furnish such information as may legitimately be asked. Without the whole-hearted cooperation of all, the best results are not attainable.

In order to avoid abuses of this nature, the Credit Men's Association, under whose auspices the report form above illustrated was prepared, has drawn up a series of rules to govern exchange of credit information among its members.

An example of reciprocal exchange of credit information is furnished by the manufacturing hatters who sell to the jobbing trade. Their entire product is put on the market thru about a dozen commission houses. These commission men cooperate in handling the trade. An actuary is hired by them, and to him all orders and payments are submitted.

5. *Operating thru a central bureau.*—While a satisfactory system of credit interchange may be conducted without the aid of a central bureau, particularly if operated on a small scale, it is usually found more convenient to maintain such a bureau, since this permits the information sought by members to

be obtained more quickly and thereby to be made more readily available to them.

The following describes a way in which this work is commonly carried on:

Let us assume that fifty wholesale houses agree to participate in exchange of credit experience, and that a central bureau is established and provided with a clerk or secretary in charge. The first step consists of giving to each member a number, and of preparing and distributing among such members a list of firms with their respective numbers. The next step is to file with the bureau a complete list of active customers, including all who have bought goods within a certain period—say, two years. A card is made out for each of these customers and is filed alphabetically. Upon each of these cards are entered the numbers of those houses that are shown to be selling the dealer whose name the card bears. Accordingly, as the clerk picks up a dealer's card he can tell at a glance what members are interested in that particular customer. He knows, therefore, where information about that dealer may be had, and he also knows what members among the fifty will be interested in learning of any change, favorable or unfavorable, that may occur in that dealer's condition.

Suppose an order comes to one of the fifty from a dealer with whom he has had no previous business. He promptly sends this dealer's name to the central bureau, and the clerk, upon examining the cards on file, discovers on this dealer's card the numbers of,

say, three of the members. He thereupon enters the three numbers upon the inquiry form and returns it to the inquirer, thereby informing the latter where information about his new customer may be obtained. The desired information may then be obtained by means of three letters or three telephone calls. The inquiring member may learn in this way that the dealer's credit is being shut off by his former supply houses on account of delinquency or unfair treatment, and may find in this fact an explanation of the receipt of the unsolicited order that prompted his inquiry. His treatment of the order henceforward will, of course, be governed by the information he has obtained thru the bureau. He may decide to request a financial statement before consenting to fill the order, or if the information justifies such a course, he may even demand cash in advance. If on the other hand the inquirer should learn that the dealer is paying his bills promptly, that he buys his goods carefully, and that in other respects he acts the part of a model customer, he would of course be disposed to fill the order on the usual credit terms, even if he should deem it advisable to carry his investigation a little further before actually shipping the goods.

Such a method can be used to advantage only when all the participating members live in the same city or within easy communicating distance of one another.

6. *Credit clearing.*—Under another plan, also operated locally, tho gradually extending its field of operation, both inquiries and the information are re-

ceived at a central office, and from there distributed among the members. Suppose that the morning's mail brings to the central office ten inquiries concerning dealers who buy in the local market. The names of the parties inquired about are entered upon a report sheet, and this sheet is distributed by messenger among the members. Thereupon each member to whom the sheet is sent enters opposite the name of each dealer a statement of his experience with that dealer. In other words, if the dealer is or has been his customer, the member enters upon the sheet the amount now owing, what part of this amount is past due, and such other information relating to the customer's payment habits, etc., as is called for, or as may seem advisable to communicate.

When these comments are received at the central office, a report is prepared embodying the sum of the information obtained. Each member receives a copy of this report. No names of informants appear upon these reports, such names being known only to the central office. For the sake of convenience, letters of the alphabet and abbreviations of words are employed in conveying this credit information.

7. *Inherent defects of credit clearing.*—Nearly ideal as this plan appears to be, there are nevertheless features which to a considerable extent limit its usefulness. For example, it will be seen after a moment's reflection that a system of credit interchange in order to be of sufficient practical value must be participated in by the larger portion of possible credi-

tors. To illustrate: If the number of possible creditors selling a certain line of goods in a certain market is one hundred, and if of this number only ten, twenty or thirty participate in the interchange system, it follows that the volume of information obtainable under such circumstances is insufficient to cover fully the credit dealings of a buyer in that market. As is readily seen, the farther below one hundred the total membership is, the less complete will the returns in this case be and the less valuable will be the interchange as a source of credit information. Conversely, the nearer to one hundred the number of participants is the more complete will the information be, and the greater also will be the value of the information obtained.

It must also be remembered that the larger the membership the more numerous will be the inquiries; hence the more arduous the work of furnishing the information asked for. It is easily conceivable that if the membership in such an association continues to grow, a point will sooner or later be reached at which the work demanded of each member in connection with the answering of inquiries and the expenditure of time and labor incident thereto—perhaps the entire time and service of a clerk—will be found to be out of proportion to the benefits derived. When that point is reached, the system plainly becomes impracticable. In that case, the membership is automatically reduced to a point where the system is once more workable. This automatic limitation seems to indicate that the

ordinary system of "clearing" ledger information will hardly attain universal application. When it is restricted to one or to merely a few markets, however, there is no ground for questioning the value and practicability of the system, always provided that the members live up to their agreement and treat one another fairly.

8. *The Credit Clearing House.*—The Credit Clearing House is, without doubt, the chief exponent in this country of the system of obtaining credit information by means of ledger experiences.

Each member of the Credit Clearing House is required to register with that agency the names of his customers and to contribute information whenever any of his customers are under investigation. In each case the member receives a copy of the report summarizing the information contributed by the other interested members in addition to that contributed by himself.

The ledger facts sought by this agency are gathered from every important market. Merchants are given an opportunity to submit their financial statements in order that the contents of such statements may be added to the other information contained in the report that is sent to inquirers. The report in its entirety is made up of the facts thus contributed and possesses the merit of being free from the bias of personal opinion.

9. *The percentage system.*—Investigation has shown that one of the chief items in such a report re-

lates to the subject's manner of paying his bills. An index to his manner of payment is arrived at by the use of percentages. Thus, if out of twenty-five reporting houses, ten say that payments are slow, this fact appears in the report as follows:

"25 payment experiences, 40 per cent slow."

If earlier reports were cleared, their percentages are also given in order that it may be shown whether the merchant is doing better or worse. To illustrate: A certain New York merchant failed in 1915. In the agency's records the percentages in his case read as follows:

February,	1913, 18 payment experiences, 22 per cent slow.
January,	1914, 20 payment experiences, 35 per cent slow.
January,	1915, 15 payment experiences, 53 per cent slow.
March,	1915, 19 payment experiences, 79 per cent slow.

Another important item covered by the Clearing House report is the attempt to buy an unusually large amount of merchandise. Such an attempt is also recorded in the form of percentages. In the case of a house that failed, the amount of new credit sought was 63 per cent. It has been found that if a dealer is slow with more than 70 per cent of his creditors, failure is likely to overtake him at any moment. A climbing percentage of new credits asked by the merchant also draws attention to a weakening condition.

Experience based upon the observation of a large number of failures shows that the failure level is reached when slowness of payments approximates 80 per cent. If new credit is also involved, the failure

level is reached when the combined percentages of slowness and new credit reach 120 per cent.

Where new credit is the sole disturbing factor, reports of new credit asked from more than 60 per cent of the houses inquired of call for careful scrutiny of the situation. Where this percentage is distinctly favorable, little fear need be felt as to the safety of the account; but when it is not so distinctly favorable, the detailed report should invariably be examined.

Except in the smaller markets, it is rarely necessary that all a dealer's creditors be included in such reports. Information from a representative body of creditors generally serves every purpose.

When the demands for new credit are found to be unusually numerous, the Clearing House calls special attention to this fact by suggesting to its members that a report should be consulted before further credit is allowed. At the same time, the dealer himself is asked by the agency to explain his increased demands, and this explanation, if at all pertinent, is sent to all interested members.

10. *Giving credit advice.*—The Credit Clearing House offers to interpret its reports for the benefit of subscribers and on the basis of such reports to render credit decisions on cases submitted to it. This service is, perhaps, of more special value to manufacturers whose business is not large enough to warrant the employment of a professional credit man.

The membership of the Credit Clearing House is

said to embrace more than thirty lines of trade and to cover the chief manufacturing sections of the country.

11. *A system based on abnormal transactions.*—The essence of this system lies in the fact that all the information received and dispensed is of a negative or unfavorable character, since it is a record of new credit sought and of slow payments. Opportunity is given the inquirer, however, to indicate by a check mark upon the inquiry ticket whether, in the case of an old customer, the last bill was discounted, paid at maturity, slow or collected by draft or attorney. Only those transactions that involve new or considerably increased credit are reported.

The peculiar value of the information given out by the central office lies chiefly in the fact that such information is not based upon anybody's opinion, as for example that of an agency reporter, nor does it have any reference to what the dealer may say about himself—either or both of which may be at variance with existing conditions. On the contrary, such a report is a concise and uncolored record of actual transactions, being made up wholly from the information furnished by the inquirers at the time their inquiries were made.

Accordingly, the satisfactory customer—that is, the retailer who always buys in normal amounts from the same supply houses, and who pays his bills with regularity—will not appear prominently in the files of the interchange office, for the simple reason that

no one has had occasion to inquire about him. The unsatisfactory customer, on the other hand—that is, the retailer who is habitually slow with his creditors, and who for that reason is always compelled to seek new credit—is likely to have a great deal of information recorded about himself, since in his case, and under the rules of the system, each slow payment and each request for new credit will have brought an inquiry, accompanied by a statement of the facts that caused the inquiry to be made.

12. *Growing recognition of credit interchange.*—Inquiry made of a number of prominent manufacturers and distributors in various parts of the country shows that the value of credit interchange is today duly recognized by all progressive manufacturers and merchants. Without exception, these houses were found to be participants in some form of ledger-experience system, either thru one or more agencies, or by means of direct reciprocal exchange with other houses. This is not at all surprising in view of the freshness and reliability of the information that may be obtained in this manner. It indicates, moreover, that in the future the search for relevant credit information will be increasingly in the direction of the credit-seeker's present activities—his purchases and his payments, rather than his possessions and antecedents.

This tendency is wholly salutary and indicates a growing comprehension of the true basis of commercial credit.

13. *A probable credit interchange system of the future.*—It seems to be fully within the domain of probability that a system of credit interchange, capable of national if not of international application, may ultimately be adopted, and that thereby the ends of trade may be fully served without the necessity of imposing a burden upon the participating members.

Such a system has, in fact, been tried in a small way, sufficiently, it is believed, to prove that it is thoroly workable and efficient. Among other features it contemplates making inquiries obligatory whenever certain circumstances arise. It also demands that each inquiry be a report, in the sense that it shall contain one or more items of information affecting the credit title of the person or firm in question. Tho it is not feasible here to describe this plan in detail, it may be said that the reasoning upon which it is founded is somewhat as follows:

1. Relevant credit information in the matter of commercial transactions is that which deals only with abnormal transactions.

2. Abnormal credit transactions, as that term is here used, includes the seeking of new credit as shown by the placing of first orders or of materially increased orders.

3. Delinquency—the owing of past-due accounts—constitutes another abnormal transaction or condition, and is therefore relevant credit information.

4. Where information covering abnormal transac-

tions is promptly conveyed, all information relating to merely normal transactions, such as the buying of goods in the usual quantities as measured by past dealings and the paying of bills according to terms of sale, is not relevant credit information, since it is of no particular value to the inquiring credit giver.

5. By eliminating all normal or purely favorable information, more than nine-tenths of the total volume of credit information which is now being collected and distributed, may be dispensed with, and the work of the credit department thereby be made correspondingly lighter, simpler and cheaper.

6. The cost of participation in such an interchange system may be made so low as to constitute no barrier whatever to an entirely free use of the system, so that no unfavorable symptom in the debtor's condition may escape the creditors' notice.

From the foregoing the reader will see that under this system the files of the central office will not be burdened with information recounting normal credit transactions, such as regular purchases and regular payments. The only source from which the bureau's information is drawn is the members' inquiry tickets, which in turn record only abnormal credit data, as just described. This being the case, it follows that the central office will have less than one-twentieth of the usual mass of credit information to care for, by which fact alone the workable limits of the interchange system are automatically enlarged some twenty times.

14. *The National Association of Credit Men.*— Among the factors that cooperate in promoting sound, efficient and honorable principles in the conduct of American business, particularly in the department of credit, a prominent place must in fairness be accorded the National Association of Credit Men. Organized in 1896 at Toledo, Ohio, this association was a direct outcome of the deliberations held at the World's Mercantile Congress, conducted under the auspices of the Chicago World's Fair in June, 1893.

Prior to that date certain associations of a somewhat similar nature had already come into existence. These, however, were chiefly credit companies or bureaus organized for the exchange of credit information. Their operations, tho limited in scope, nevertheless formed the nucleus of the national organization with which subsequently they became identified.

The objects for which the National Association of Credit Men stands have been summed up as follows:

1. The organization of individual credit men and of associations of credit men into one central body.
2. A more uniform and firmer basis for granting credit in every branch of commercial enterprise.
3. Reforms in the laws that are unfavorable to honest debtors and creditors.
4. Adoption of new laws beneficial to commerce.
5. Improvement in the methods of gathering and disseminating credit information.
6. Amending business customs for the benefit of all commercial interests.
7. Providing a fund for the protection of members against injustice and fraud.

These objects have been pursued with much zeal. Considerable success has attended the association's effort to spread information relating to sound credit practice. Both in its defense of the National Bankruptcy Law against the attacks of those who have sought its overthrow, and in its successful efforts toward obtaining constructive legislation—state and national—the association has proved its worth to the American business world.

The membership of the association has increased rapidly until, today, the growing influence of its work is felt thruout the land. Some of the local branches have a membership of more than one thousand.

At the annual meetings of the association, subjects pertaining to the education of business men, not only in the department of credit but also in other branches of commercial activity, are freely discussed. As an educational center for credit men, the association is doing good work, not only by means of liberal distribution of instructive literature, but—and especially—by its efforts to establish, under the direction of capable instructors, classes for the study of sound credit principles and approved credit practice.

In keeping with its avowed purpose to seek the enactment of laws favorable to honest debtors and creditors, the association has taken an active part in the promotion and defense of national bankruptcy legislation. Tho not universally indorsed—in fact

actively opposed by some—the National Bankruptcy Act appears after all, to be one of decided advantage to American business.

Also in other legislative efforts has the National Association taken a leading part. Thus in promoting the enactment of bulk sales laws in the various states, the association has done valuable service in the protection of creditors against fraudulent debtors. The modification of unfair exemption laws and the vigorous prosecution of commercial fraud are among the objects actively sought by the association.

15. *Association ethics.*—Among the "canons" of commercial ethics adopted by the National Association of Credit Men are the following, which sufficiently indicate the high moral and altruistic plane upon which the association conducts its work:

> In times of trouble the unfortunate business man has a right to appeal to his fellow business-men for advice and assistance. Selfish interest must be subordinated in such a case, and all must cooperate to help. If the debtor's assets are to be administered, all creditors must join in cooperating. To fail in such a case is to fall below the best standards of commercial and association ethics.
>
> Terms of sale as a part of a contract touching both net and discount maturity, are for buyer and seller alike binding and mutual, unless modified by previous or concurrent mutual agreement. No business gentleman may, in the performance of his contracts, seek small or petty advantages or throw the burden of a mistake in judgment upon another, but must keep his word as good as his bond, and when entering into a contract of sale, faithfully observe the terms and thus redeem the assumed promise.

16. *Retail Credit Men's National Association.*—Occupying in the retail field a position corresponding to that held in the wholesale field by the National Association is the newer but no less active Retail Credit Men's National Association. It has grown and developed in response to the need for a permanent organization to improve retail credit conditions.

Its objects are much the same as those of the National Association: to promote better education of retailers and customers to the better understanding and appreciation of good credit relations; the exchange of information and experience among retailers; to promote uniformity of retail credit and collection policy and practice and to seek for consistent improvement of laws dealing with individual credit seekers and the enactment of new laws for the benefit of retail credit grantors.

The official organ and mouthpiece of the retail credit men is the monthly magazine called the *Credit World,* which circulates widely among local associations over the country and which serves as a very helpful medium for the exchange of much beneficial information and experience.

REVIEW

What features of credit information are covered by so-called ledger experience?

What are the chief advantages of a credit-interchange system as compared with other means of obtaining credit information?

What is credit clearing, how is the system operated and what is its inherent defect?

What needs are supplied thru the association of credit men?

CHAPTER VIII

ANALYSIS OF CREDIT INFORMATION

1. *The financial statement; merchandise on hand.* —When all available credit information has been collected, the most important part of the credit department's work still remains to be done, namely, to analyze this information in order to reach an intelligent conclusion. We shall consider here some of the chief items that appear on the financial statement forms that are now commonly used. (See forms on pages 104–106.)

Cash value of merchandise on hand is necessarily one of the important asset items. In examining this item, we should consider first of all its size in relation to other asset items and to annual sales. If it appears to be disproportionately large, the item becomes a subject of careful inquiry. It may indicate an overstocked condition which not only constitutes a real danger in itself but reflects unfavorably upon the business ability of the merchant.

The value of stock on hand should always be compared with volume of annual sales, in order to obtain some idea of the number of times the stock is turned in the course of a year. If the normal turnover in the line of business under investigation is known,

such comparison will show, in a general way at least, whether or not the business is efficiently managed.

The next thing to be noted in connection with the merchandise stock is how it has been inventoried. Is the stock all fresh and salable so that it may be disposed of in the regular manner, without resort to special sales or to unusual and expensive advertising, or does it represent, in part, old and unsalable goods?

If the stock consists in part of unfinished goods, or of goods in process of manufacture, how much of each? Is the raw material inventoried at current market prices?

2. *Notes and accounts.*—The custom, which at one time was popular, of giving notes for merchandise has largely gone out of use. Today, with the exception of a few lines of which the building and contracting trade and the agricultural implement trade are examples, the retail dealer buys his goods on open account, tho it is not improbable that open accounts will gradually be replaced by trade acceptances. The appearance of notes receivable in a manufacturer's statement therefore generally prompts an inquiry as to what they are for. They may represent old and uncollectible debts, long carried and renewed again and again, they may be notes given by a member of the firm for money advanced him, or they may represent other items of such a character that the notes cannot be considered good paper.

Accounts receivable should, in common with merchandise, be considered in its relation to the amount

of annual sales as well as to the credit terms which obtain in the trade. If the proportion of accounts receivable to annual sales is unduly large, a lax collection policy and lack of financial ability on the part of the management are implied.

It is also important to know how the cash value of these accounts has been estimated. Any attempt to pad the statement will almost certainly appear here.

Before deciding to grant credit on these accounts without further security, it is always well to inquire whether they, or any part of them, have been pledged for loans.

3. *Cash on hand or in bank.*—The necessary freedom in the financing of the business requires adequate cash on hand or in bank. A small amount of cash where the volume of sales is large, and when accounts and bills payable are correspondingly heavy, means that the dealer is courting danger. Any little flurry in the market may send him scurrying for funds while the smallness of his bank balance deprives him of the right to demand accommodation from the bank. Large and otherwise well-managed concerns have been known to place themselves in this position and to have experienced the greatest difficulty in financing themselves when times of stress suddenly overtook them.

Unless a growing volume of sales is accompanied by a corresponding increase in the item of cash on hand or in bank, there is strong indication of inferior financial management.

4. *Fixtures, machinery, etc.*—Items under this heading should always be considered in relation with the amount of capital which the applicant has on hand. The realizable value of such assets is not easily determined apart from an investigation of the several items from which they are made up. As a rule, such values must be heavily discounted.

The accurate valuation of good-will, patents and trade-marks is always extremely difficult and often wholly impossible. For that reason the merchandise creditor will not ordinarily consider them in his estimate of a customer's assets.

5. *Owing for merchandise on open account.*—This item must be viewed in its relation to the volume of sales and to accounts receivable. It should also be considered in connection with bills payable. If the last item is large, accounts payable should be small, on the assumption that the proceeds from bills payable have been used for discounting merchandise bills.

Where this item is separated into amounts past due and amounts not yet due, a further insight into the financial methods of the concern is afforded.

6. *Owing to banks and to relatives.*—The items showing debts to banks and to relatives and friends not only show how much is owing, but indicate the dealer's ability to borrow in case of necessity. Possibly the banks have already been used to the limit of their willingness.

7. *Outside assets.*—When outside assets consist wholly or largely of real estate, they had better not

be considered as a basis for merchandise credit. At best they are slow assets and difficult to realize upon in case of forced liquidation. Frequently such assets are hedged about with conditions that make them wholly unavailable for merchandise creditors. While they are not to be thrown out as of no value, since they sometimes remain when other assets have disappeared, they should not ordinarily be included in an estimate of a merchant's title to commercial credit.

This item, however, affords an insight into the nature and extent of the merchant's investments. If these investments are of such nature as to demand the owner's active supervision, they may seriously interfere with his giving proper attention to his regular business, just as they may prove a drain upon his funds and thereby hamper—possibly even cripple—the business for which he is seeking credit. If the outside assets appear large an explanation should be asked.

8. *Convertibility of assets.*—Of even greater importance than the relation of assets to liabilities is the degree of their convertibility. Some assets, such as building and fixtures, are not readily convertible into cash and are therefore termed "slow" or "fixed" assets. Salable merchandise and goods receivable, whether in the form of book accounts or notes, are usually turned into money without much difficulty and are therefore called "quick" or "liquid" assets.

A comparison of quick assets with slow assets will show the amount of the dealer's active capital, and

will indicate with considerable accuracy to what credit accommodation the dealer is entitled. Even the quick assets, however, shrink considerably when an attempt is made to realize upon them by means of a forced sale. In the case of slow assets, such shrinkage is at times considerably in excess of fifty per cent. Particularly is this the case with the equipment of a manufacturing plant. Such items as tools, patents, special machinery and fixtures, while they may be worth their full valuation to the business in which they are employed, usually are of little value elsewhere, and at forced sale bring but a small portion of their original cost.

It is a matter of common observation that merchandise is convertible into cash in direct proportion to its nearness to a state of raw material. It is much easier, for example, to turn wool or iron into money than it is to convert clothing or hardware into money. The explanation is that since manufactured goods are in a special and narrower class than the raw material from which they were made, their utility is restricted, and hence their sale is effected with greater difficulty.

The character of the business in which the dealer is engaged will have an important bearing on the credit granted. No credit man looks for the ultimate collection of his debt thru legal processes, but nevertheless he remembers that in certain lines of business, the assets can be converted into cash on a forced sale with less loss than in other lines.

9. *Can more definite rules be given?*—However important the foregoing considerations, it must be admitted that they are somewhat vague and indefinite. Is it possible to reduce them to mathematical terms or to devise formulas which when applied to accounts will render the same service but with greater precision? Mr. Alexander Wall of the National Bank of Commerce of Detroit has made a notable contribution to credit practice in pointing out the possibility of a more scientific analysis. Whether the procedure which he favors will be accepted in all its detail remains to be seen but the principle upon which it is based is eminently sound.

10. *Business types.*—Financial statements, says Mr. Wall, in effect, are neither all alike nor all different. The common empirical rules for their interpretation are, of course, based upon the idea expressed or unexpressed that they are all alike. If the contrary were to be assumed there could be no rules whatever. It would be a case of forming an opinion on many given situations without knowing just why it was done, a procedure which outside of business operations would be called blind chance.

But, of course, the truth is that some financial statements are alike and some different. There is every reason to suppose that there is a family resemblance between grocers' statements, but one would not expect a like similarity between such statements and those of dealers in drugs or dry goods or hardware or shoes. A composite picture of all statements

would give a very hazy and uncertain outline. A composite picture of all statements of one class would in all probability reveal a definite type.

11. *Typical statements.*—Mr. Wall's conclusion was that if there was in each line a typical business, there must be also a typical business statement. Proceeding on this belief he has collected from various sources a large number of statements in several lines of business and studied their characteristics.

From this study he has evolved a typical statement for each line. This statement is expressed in the form of a ratio. The starting point is the well-known ratio between current liabilities and current assets. In present day practice, if the assets are double the liabilities, the credit risk is considered safe, but Mr. Wall has his doubts regarding the uniformity of such a rule. In addition his analysis goes further and establishes other ratios, and his seven point scheme requires the following:

1. Current Liabilities and Current Assets
2. Receivables and Merchandise
3. Worth and Fixed Assets
4. Debt and Worth
5. Sales and Receivables
6. Sales and Inventories
7. Sales and Worth

Under the foregoing the term "worth" has been used to indicate the total of capital, surplus and un-

divided profit; otherwise the terms are self-explanatory.

In the study of the statement, he establishes the normal ratio and also the range from which such ratios are computed. Having established a normal and what might be designated as the range of permissible deviation, he is able to test any individual statement which may be presented for consideration. Any marked departure from safe business will reveal itself in one if not in more of the ratios which have been established. Thus, it would be a danger signal to the credit man, and while extraordinary circumstances might warrant the granting of the credit, it would, at least, put the credit man on his guard and show him the need for further investigation.

12. *Varying considerations.*—The same procedure which was adopted for one line of business, for example, grocery, is adopted for other lines, dry goods, hardware, and so forth. In each of these lines, the typical set of ratios is developed together with the permissible variation which can exist without impairing sound business conditions. These ratios are never alike thruout for two different lines of business, tho they may be practically identical in one or more particulars.

The studies which Mr. Wall has made have convinced him that the old rule that current assets must be double the current liabilities is an unsafe guide in granting credit in some business lines. In some instances, it may be considerably more than double, and

in other lines there is a possibility that it may be slightly less. Further study of the typical figures will serve to reveal more and more the significance of the less familiar ratios.

The objection which has sometimes been made to the seven point analysis of Mr. Wall is that it is cumbersome, but it may be met by saying that the calculations required to ascertain the ratios can be made very quickly by the logarithm method, or if a memorandum of calculations is not deemed necessary can be rapidly computed by the use of the slide rule.

13. *The effect on credit information.*—There can be little doubt that if the plan here suggested were to come into wider use, it would bring with it further information to the credit man. In another chapter of this Text, it has been shown how important is the matter of turnover which is Mr. Wall's sixth point. The latter has found in the course of his researches considerable difficulty arising from the fact that applicants seem reluctant to report the amount of annual sales, altho this is not only a vital part of his scheme, but is essential to a clear understanding of the financial position of the house requesting credit. With the need for other particulars which a further analysis will no doubt develop, other particulars will probably be required by the future credit man which at the present time have no place in the customary financial statement.

14. *Analysis of agency reports.*—In a former chapter we noted that the applicant's credit title is de-

termined by the presence of business ability, financial strength and moral integrity, or the "Three C's"—capacity, capital and character. We shall now examine in the light of these three factors, typical credit reports of the kind that come to credit men's desks in the ordinary course of business.

15. *Report on a manufacturing firm.*—The following is a Dun report on a manufacturing firm and contains several items of importance in connection with the determination of existing credit title:

Brown, R. S., and Company. Scranton, Pennsylvania.
Mnfrs. Trunks.

Brown, Robert S.
Harris, Charles H.

June 15, 19—.

The business was started by the above partners and one Fred Carlson, some six years ago, and upon Carlson's death, which occurred a year or two afterward, Brown and Harris acquired his interest for $2,700 cash, paid to his widow.

The remaining partners have worked in the same line of business for a number of years, both here and in Philadelphia. They are both middle-aged; Brown is married and Harris is a widower. Enjoy a fair reputation and are considered to possess only fair business capacity.

Repeated requests for a statement of their financial condition have been ignored. Are not inclined to talk much about their affairs.

The former owners of the plant failed in business, and their predecessor, who was the builder of the plant, is said to have lost money on it. The present owners bought the plant for $12,500. Appear to be doing a fair business, tho it is generally believed that they are not making substantial headway. The shop is running full time and employs from twelve to eighteen hands. Carries a fair stock

of lumber and other supplies. Brown owns his residence, which he values at $5,500 and which is mortgaged for $3,000.

Harris' own business property is valued at $8,000, mortgaged for $5,200.

One supply house of whom inquiry was made reports that bills are paid with a fair degree of promptness. Another reports them slow pay, altho it is willing to sell them in moderate amounts. Believes they are not making sufficient margin of profit on their product.

16. *Analysis.*—Applying to the foregoing report the test of capacity which, as will be remembered, we divided into technical and financial, we note at once that the firm is credited with possessing only "fair" ability, from which we gather that their business ability is really poor, tho their skill as practical trunkmakers may be excellent. This conclusion is strengthened by the further evidence that altho they have been in business for six years, the partners appear to be merely holding their own and are making no appreciable headway. This condition is readily accounted for if, as the trade believes, their product is sold on too close a margin of profit—a circumstance which lends additional support to the opinion that the partners are men of small business ability, as is also suggested by their refusal to submit a financial statement.

It is not doubted that their technical ability as trunkmakers is satisfactory. Their long experience must be accepted as sufficient guaranty of that fact. The ages of these partners must also be regarded as being in their favor.

Under the second C—capital—the information is not sufficient for us to form an intelligent opinion. We know that six years ago the business was bought for $12,500, but in the absence of a financial statement we have no means of knowing whether the assets of the business at the present time total that amount.

The information before us does not indicate whether the business premises are owned by the partners or are merely leased by them. The supposed equity in the properties of the individual partners should not be taken into consideration as a basis of credit. Nor do we know whether the plant is fully insured—not even whether it is insured at all.

Under the third C—character—we note that the partners are said to have a "fair" reputation, which implies that there are things in their history which show them to be not wholly upright or trustworthy. This makes us cautious. There is nothing in the report to indicate that the partners gamble, drink or neglect their business, nor are we warranted in concluding that they are extravagant, either in their personal or in their business expenditures. But we do know that they are somewhat slow in paying their bills—in the words of the report, only "fairly prompt."

To sum up our analysis, we find that the partners' business ability is not such as to give assurance of the ultimate success of the business. As to their capital, we are not sufficiently informed either as to its

amount or condition (quick or slow assets). It is true that two creditors declare themselves willing to continue selling the firm, but it is highly probable that these creditors are in possession of certain information that is withheld from us. Until we know what the firm's assets and liabilities are we cannot be certain that there is capital sufficient to guarantee us against loss.

As to the question of character, we unfortunately lack definite proof that we are dealing with men of proper moral standards.

Under the circumstances we are not warranted in accepting the firm's orders except on a cash basis. It is quite probable, of course, that a first bill of relatively small amount would be paid, but even on that eventuality we cannot afford to take chances. If our customers will not open their hearts to us and give us their confidence, they cannot in reason expect us to open our stock rooms to them and give them possession of our merchandise. Until we have fuller and more satisfactory information we shall decline the order.

17. *Advance report and salesmen's data.*—In not a few houses, especially of the larger kind, it is customary to obtain agency reports upon prospective customers in advance of the salesman's visit, and to compare such reports with the information furnished by the salesman in order to have a basis for prompt shipping of a first order. The following case is illustrative of the value of this procedure and is cited here

as given, except that—in common with other reports herein reproduced—names of persons and places have been changed.

COMMERCIAL AGENCY REPORT

Simmons, Andrew. Horton, Michigan,
Cloaks, D. G., Not's, Women's Furn'gs, etc. 502 Second Street.

August 11, 1915.

He is a middle-aged, married man and has been here in this line since March, 1912, prior to which he was in the general store business at Joliet, Illinois, and previously had experience in the same line at Newburg, Illinois, where he failed. For some time subsequently conducted business in his brother's name. He succeeded his brother, Joseph Simmons, having previously compromised his old indebtedness at from fifty to seventy-five cents on the dollar. His failure occurred twenty-three years ago, and of late years no criticism is known to have been made on that account. Interviewed in March, 1914, he submitted a signed statement showing inventory of January 30, 1914, claiming merchandise on hand $22,680.75; outstandings, etc., $1,380; cash on hand, $68; cash in bank, $562; fixtures, $1,500. Other personal assets consisted of notes, $500. Liabilities: For merchandise not due, $900; loans from banks, $4,000; real estate at Joliet, $6,740, mortgaged for $2,600. Insurance on stock, $8,000; on real estate, $3,500. This statement was believed to be a fair showing of his condition from his point of view, tho somewhat subject to shrinkage in arriving at a realizable basis.

Interviewed under date of October 29, 1914, he stated that he had decreased his loans from banks as shown in statement of March, 1914, $2,000; also that his stock was larger than formerly. He suffered a fire loss November 28, 1914, caused by a gasoline explosion, and under date of December 20 called and stated that about a month previ-

ously he arranged to instal a gasoline lighting plant in his store, such as he had previously used in Illinois, on which account all his insurance, which amounted to $8,000, was canceled. When filling his tank with gasoline on the evening of November 28, an explosion occurred resulting in damage which he estimated at $1,500. He had that day arranged for a loan of $2,000 from the bank, and before the explosion that evening had mailed checks to thirty-two creditors, the amounts aggregating $1,909.36. After the fire his store was closed for two weeks and he was unable to attend to business. As he had intended to complete the loan the next day, he had practically no balance in the bank and his checks went to protest. This, he said, was satisfactorily arranged, and on the reopening of the store the sales of three or four days brought in enough money to pay them all off with one exception—that being a bill of about $150, where the creditor had crowded him. As soon as he reopened, he had the gasoline lighting plant taken out and put in electricity again and insured his stock for $10,000. He has taken no inventory recently, but on December 23, 1914, he estimated his stock at just about $1,500 less than it was in statement of January, 1914. He submitted a list of his liabilities aggregating $6,014.32, including $2,000 to bank and covering claims of forty-one creditors, eight of which were for more than $100, but none of them reaching $1,000. Stated that he had $600 in bank and that except for the loss of two weeks' business, his condition was not materially worse than it had been before the fire. Stated he had been holding sales and clearing off dead stocks, and expected to do a good business in January after the holidays.

His statement in regard to the trouble and to his present condition was accepted as correct. At this time he appears to be doing a good business; gives close attention to his affairs, and so far as could be learned he is meeting his current obligations as he agreed.

18. *Analysis.*—There is in the foregoing report nothing to show that the merchant is unworthy of con-

fidence. His failure in business some twenty-three years ago is not held against him by the trade and no suspicion of trickery exists in that connection. His history, as far as known, shows him to have been willing enough to take care of his obligations, and his present inabilities may well have been induced by the unfortunate fire in his store.

The report does not enlighten us as to his business capacity, except that it shows him to have had experience in his present line. Without knowing the amount of his annual sales it is difficult to judge whether or not his stock is too large for his capital.

From the data furnished by his signed statement of January, 1914, and his oral statements of October and December of the same year, it would appear that his net worth, even if we disregard his equity in the real estate at Joliet, should be in the neighborhood of $15,000. Discounting this one-third, we should still have a credit basis of $10,000. The fact that he is reported to be doing a good business and to be giving his affairs close attention, also that he is meeting his current obligations as he agrees, would dispose us to consider favorably the opening of an account with him. The salesman's report is therefore awaited with interest, as probably supplying information that will confirm our impression.

In due time the report arrives and reads as follows:

SALESMAN'S NEW-CUSTOMER REPORT

Amt. of order—*about $310.00* Date *Nov. 20,* 1915.
Sold to—*Andrew Simmons*
Post-office address *Horton* State *Mich.*
R. F. D. County.

INDIVIDUAL OR FIRM

A. S., Sole prop. Age? *about 55.* Married? *Yes.*

GENERAL INFORMATION

Kind of Bus? *D. G.* Est. vol of stock?
Condition of stock? *Broken lines* / *Old stock.*
How long in bus? *3 1/2 years* Insurance? *Yes.*
Est val. of R. E. (subject to debt) Safe amt. to credit?
Pays $50 per month rental for store $ consisting of

Character? *Good.*
Store favorably located? *Yes.* Bus. ability? *Doubtful.*
Attentive to customers? *No.* Stock well displayed? *No.*
Capable clerks? *Wife sole assistant.*
Does banking with? *Horton State Bank.*
Present crop prospects? *Good.*

Buys from firms named below:
A. Hartman, Chicago.
Theo. Fass & Co., Chicago.
Felix Bros. & Co., New York.

Write your own opinion on the other side.
W. F. Merritt,
Salesman.

Upon the other side of the sheet we find the following notation:

Mr. Simmons is a peculiar and taciturn man, and I found it very difficult to obtain any information from him. His only assistant is his wife, who appears older than he, and who is quite talkative. She does not appear to be a good saleswoman, is tactless and untidy. The premises are not well kept, both the exterior and the interior being in need of

painting and other repairs. Window display appears not to have been changed lately, and is poorly arranged. I visited the store twice during the day and found trade light. Three weeks ago a competitor started three or four doors above, with modern fixtures and new stock well displayed, and I am of the opinion that the newcomer will absorb a good portion of Simmons' trade.

My judgment of Simmons is that he is industrious and attentive, but lacking in ability. Does not appear to have any idea of how to gain and hold customers, but is selling on a close margin, which probably accounts for whatever trade he has. I took his order, but would advise a close investigation of his affairs before filling it.

Yours very truly,
W. F. Merritt.

The salesman's report in this instance decides the question. Mr. Simmons will be required to pay C. O. D. for any goods he receives from the house. The condition revealed in this report is one step toward the bankruptcy court. While it is not improbable that the present order would be paid for before the crash comes, it will not be safe to take the chance. Moreover, after reading the salesman's report, a doubt is created as to the correctness of the figures contained in Mr. Simmons' statement to the mercantile agency. It is to be feared that if put to the test the assets would undergo a material shrinkage.

Accordingly, a letter is written to Mr. Simmons, in which he is courteously informed that in view of the absence of sufficient information about his credit standing it is hoped that he will consent to have this order filled with draft attached to bill of lading, un-

less he prefers to send his check to cover in order to prevent delay.

In this case, as a matter of history, the requested consent was not given—it was not, in fact, expected, and the correctness of the credit man's attitude was further demonstrated when, in less than thirty days, the following notice was sent out by one of the large commercial agencies:

Simmons, Andrew. D. G. Horton, Michigan. December 16, 1915. There was filed in the clerk's office of the United States District Court on the 16th inst., an involuntary petition in bankruptcy by A. Morlik & Company of Chicago, Ill., A. I. Baumgarten, and Jacob Goldstone & Co. of Detroit, Michigan, in which they seek to have the above named declared insolvent claiming to be creditors of the above in the sum of $2,456.55.

REVIEW

In considering a financial statement submitted as a basis for mercantile credit, what particulars should you wish to know about accounts receivable?

What is the "seven point scheme of establishing ratios between figures shown in items of the financial statement?"

In the reports submitted show how the three basic considerations for the analysis of a report have been applied.

CHAPTER IX

THE CREDIT MAN

1. *Credit man's place in the scheme of business.*— The existence of the credit man as a distinct functionary in business is a result of the development of that system of credit-giving which has grown up in connection with the sale of goods on credit. Matters of credit, in common with other questions of business policy and business practice, were at one time decided by the owner or general manager. But with the increase of retail stores within the reach of the jobbers' salesmen and with the growth of the present system of credit-giving the matter of passing upon a customer's credit title came to be a special function in the hands of a special official who could devote the necessary time and attention to making credit investigations. As competition grew keener and profit margins grew smaller, the importance of the credit man in preventing losses became correspondingly emphasized in practice, until today he is rightly regarded not only as an indispensable factor in modern merchandising but as a constructive force in the scheme of business.

The best credit man is undoubtedly he who checks the largest number of orders with the fewest losses. We must remember, however, that a credit man

may err on the side of being too conservative just as readily as on that of being too liberal. He may be so afraid of sustaining a loss that he will pass only the orders which he knows to be absolutely safe—orders from highly rated and well-known dealers. Such a policy would not ordinarily save money for the firm; on the contrary, it would in most cases result in a loss. For in turning down orders that came from less substantial dealers, the credit man would be depriving his firm of the profits on many orders that, if accepted, undoubtedly would be paid for according to terms of sale. On the other hand, a too liberal credit policy that permits the checking of orders without due consideration of the probability of their being paid, will most certainly increase the percentage of annual losses and correspondingly reduce the firm's ultimate profits on the year's trading.

In order to be of the greatest value to his house the credit man must accordingly steer a middle course. He must take some chances, altho these should never be blind chances. He must always firmly decline to check an order if a well-founded doubt exists in his mind with regard to the probability of the ultimate payment of the account.

It follows then, that only by ceaseless vigilance and thoro investigation of the conditions that surround the credit-seeker's business—to which reference was made in an earlier chapter—can the credit man check the largest possible percentage of orders while keeping his losses at a low mark.

2. *The question of authority.*—Difficulties often arise because the authority given the credit man is not clearly understood by all concerned and clashes of authority ensue. There are some credit men who believe that their authority should be absolute, and that no one of coordinate rank or even of superior rank in the general organization of the business should question in any way the decisions of the credit department.

Unless the head of the firm is the direct head of the credit department, it would be an abdication of proper executive supervision to place such unlimited power in the hands of the credit man. There seems to be no good reason why the head of this department any more than the heads of other departments should be granted extraordinary power.

The effectiveness of an organization does not depend so much on placing one man above another, or of defining the exact limits of each man's powers, as in causing them to work together cordially and harmoniously for a common purpose. If one man is to dominate another let it be not by virtue of rules and orders, but by reason of a forceful personality. It is doubtful whether any hard and fast lines can ever be set up in so perplexing a situation as the relation of the credit man and the sales manager. If each tries to understand the other's point of view and has a sympathetic appreciation of what it is, they can be depended upon to reach a good working basis.

Many credit men have incurred the ill-will of the

sales department by arbitrary rulings in cases where there was at least room for doubt in favor of the customer. The capable credit man realizes that the real interests of the departments of sales and credits are identical. He knows that the success of the house depends upon the profitable sale of merchandise, and he realizes that in the promotion of this work the two departments are jointly interested, since the ultimate success of a department, like that of an individual officer or employe, is necessarily contingent upon the success of the house itself. The credit man should be among the first to recognize the necessity of cooperation among all departments, and should be guided by it in his attitude toward the department of sales.

Perfect candor, a spirit of democratic equality and interdependence, rather than an attitude of isolation and superiority, should characterize the credit man in his relations with the sales department. An explanation on his part of the reasons for his decision will generally go far toward removing any possible resentment in the sales department. If there is anything in the credit man's attitude that is antagonistic to the salesmen, it obviously hinders the necessary cooperation, and to that extent constitutes a detriment to the business as a whole.

3. *Attitude toward the customer.*—It is, however, chiefly by his attitude toward the customers of his house that the credit man's value to the house is determinded. It is his duty to make their dealings with his house so pleasant and profitable that not only will

their accounts at all times be in a satisfactory state, but a continuance of their patronage may be expected from year to year. If the credit man's duties are intelligently apprehended and conscientiously performed, he may even develop the customers' ability as merchants, with a view to obtaining for them a stronger position in the local field and a larger net revenue from their annual sales. Of the latter we shall have more to say presently.

Modern American merchandising methods do not tolerate the old maxim, *caveat emptor*—"let the buyer beware." The slogan: "money back if dissatisfied," today governs the conduct of practically every department store and of a large proportion of other retail stores thruout the country. And while for obvious reasons it is not practicable for a wholesaler to permit a retailer to return goods at will and get his money back, yet good practice demands that the wholesaler stand ready to adjust, without question or quibble, any defects in merchandise or any loss which his neglect or error may have caused the retailer.

Upon the credit man the task of making such adjustments usually devolves. He should be able to make his customers feel that he is looking after their interests, and that he will protect them in any dispute that may arise in which they have a real grievance. This confidence on the part of the customers goes far toward establishing and maintaining cordial and satisfactory trade relations between the wholesale house and the retailer.

The credit man's desire to please customers must not, however, be permitted to obscure his views or affect his sentiments with regard to the importance of observing the credit terms of the house—in other words, of meeting payment obligations promptly and fully. Nor should he ever assume the attitude of one who regards such promptness as a favor or as a matter to be governed by the convenience of the debtor. Strict observance of terms should be expected as a matter of course, and should be consistently reflected in the credit man's attitude on all occasions. Since a reputation for promptness in paying his bills is one of the strongest business assets a dealer can possess, it follows that if the wholesaler's credit man succeeds in instilling in the retailer a proper regard for such promptness, he is rendering him a distinct service. We shall see presently how such a policy may be carried out in detail.

4. *Mental qualities desirable in a credit man.*— The position of credit man calls for a person of executive ability. He must, first of all, be observant. There are many avenues thru which credit information of one kind or another reaches the credit man's desk. An apparently insignificant bit of news may have value as indicating the trend of things in a debtor's business. Such signs may be found in failure to take advantage of the cash discount or perhaps in buying in a new market, or in any one of a number of things the unusual character of which sounds a warning note in the ears of the alert credit man.

As an illustration of this ability to "put two and two together" may be instanced a case that occurred in a New York bank. A certain depositor, a small jobber in woolens, presented one day a dozen or more bills receivable for discounting. Among these was a note for $275 issued by a local house rated by at least one of the large mercantile agencies as worth between $200,000 and $300,000, and as being a "good pay." Much to the surprise of the holder of the note the bank's credit man declined the offering without explanation. Upon being pressed by one of the bank's officers to give his reason for refusing the note, the credit man said in substance:

That the big house should buy of the small jobber at all is noteworthy. Under normal conditions such a house would have larger and better sources of supply. When therefore it turns to a small jobber for its necessary supplies, buying in small quantities and, of course, at higher prices, it throws out a strong hint that its credit is nearly, if not altogether, exhausted. This conclusion is strengthened by the fact that this well-rated house is compelled to give its note for the small amount involved. I conclude that if such a house finds itself unable to buy a small bill of goods on open account in the home market, it is upon its last legs and is tottering to its fall.

The sequel proved the credit's man's conclusions to be right, as within a very short time the affairs of the house were suddenly and shockingly brought to public attention thru the self-destruction of the proprietor.

Tho the house had succeeded—undoubtedly thru some form of deception—in keeping up its mercantile agency rating, it was in fact hopelessly insolvent.

A good memory is of great value to the credit man. He is constantly called upon to keep in mind a variety of facts regarding trade conditions, the history of many of his accounts, approaching due-dates and the like. While it would be a great mistake to try to carry all his information "under his hat"—especially in view of the fact that his enforced absence on account of illness or for any other cause would most likely prove embarrassing to his substitute—the credit man, by reason of the nature of his work, is constantly drawing upon his memory for important facts relating to the work of his department.

A credit man needs, moreover, a thoroly analytical mind. The ability to examine facts dispassionately and to form conclusions based strictly upon the evidence at hand, is necessarily of value to everyone, whether he is engaged in business or not; but to the credit man such ability is indispensable.

An open mind, an unbiased judgment, and firmness in executing his policies—these are among the mental qualities that we look for in a man who presides over the credits of a business house.

5. *Moral and social qualities.*—To say that the credit man should be governed by high moral standards is merely to state what should be true of every business man who hopes to make a lasting success of his vocation. Yet the credit man, in his desire to

serve his house, is perhaps put to the test in this respect more frequently than any other business functionary. Not infrequently, for example, he is called upon to take the customer's side against the house—a duty which a morally weak man would be strongly tempted to shirk.

Always a man of his word, the competent credit man will make neither a promise nor a threat unless he is prepared to carry it out to the letter. To use courtesy and kindness is quite necessary if he would gain and hold the good-will of his customers. In fact, readiness to help an unfortunate dealer who needs assistance may be as much of a credit man's business policy as insistence upon the observance of credit terms under all normal circumstances. A customer whose business has been saved by such means from extinction is not likely to withdraw his trade in favor of another supply house.

Social qualities which enable him to mix readily with all sorts of men and to be liked personally also form an important part of the credit man's equipment. A disgruntled customer—no matter whether or not there is sufficient reason for his displeasure—is a liability to the house, and may require very tactful and diplomatic handling.

6. *Special training.*—While the value of a good general education needs no emphasis, the credit man should have had also a broad business education. A knowledge of business processes, factory organization and office management is important. So also is

familiarity with distribution plans and selling processes. The latter involves, of course, also an understanding of advertising as related to marketing of products, and of the various avenues thru which the public is made acquainted with the manufactured goods.

Tho it is not necessary that he be an experienced accountant, the credit man should have a very fair understanding of accounting principles and methods, since he is constantly called upon to analyze financial or property statements issued by credit-seekers. Balance sheets and profit-and-loss statements reveal facts of great importance to the credit-giver. Not infrequently, the credit man is also in charge of the accounting department of his house, in which case he must as a matter of course understand both the principles and the practice of modern accounting, including an elementary knowledge of cost-finding principles.

In addition to his knowledge of production, marketing and accounting, the credit man requires considerable knowledge of financial subjects. Most likely, many of his customers are corporations, hence it is important that he should know something of corporation finance and of the legal aspects of corporate business. Again, the credit man has more or less intimate dealings with the banks. He should therefore be acquainted with banking principles and banking practice in order to know how the banks can serve his interests most economically and efficiently.

Since capital is a commodity that is bought and sold, much the same as other goods for which there is a fluctuating demand, and since prices in general are affected by the rate of interest, it follows that the credit man should have some knowledge of the current financial situation, the work of the stock exchange and the investment market. He may at certain seasons of the year have funds to invest, just as at other seasons he may take advantage of the low interest rate and borrow for current requirements. Without a fair knowledge of investment he will find it difficult to use the firm's funds and credit to the best advantage.

Insurance is likewise a live topic to a credit man. He will nearly always wish to make sure that the retailer to whom he extends credit has his store and stock adequately insured. For that reason, some knowledge of fire insurance, the various kinds of insurance policies, insurance companies, etc., is very desirable. In the same way, familiarity with real estate law relating to the holding and transfer of title is often of great value to the credit man.

A certain knowledge of law is of course indispensable to a successful management of the credit department. Such subjects as contracts, agency, negotiable instruments and bankruptcy, in addition to exemption and homestead laws in the states in which his house is doing business, should be known and understood well enough to guide a credit man in the ordinary transactions of his office. It is not meant by

this that he should undertake to be his own lawyer, but he should know enough law to be warned when he is approaching legal difficulties, so that he may summon competent legal aid in time to prevent loss.

Above all, the credit man should understand the subject of credit. This statement may appear so obvious as not to call for emphasis. This requirement, however, is not met by a mere familiarity with credit routine, as is often seen in the short-sighted credit policy of some houses. It is found rather in that broader view of the subject which takes cognizance of the nature of credit, not as a necessary evil but as a great boon, the right use of which promotes trade by facilitating the exchange of commodities and assures business permanency and freedom from commercial loss.

7. *The credit man as a business force.*—Aside from the immediate duties involved in checking orders and collecting credit information about customers, actual and prospective, the modern credit man finds a line of work awaiting him which fully equals these duties in importance. The manufacturer and wholesaler recognize more and more clearly that the best way in which to promote their own business is to promote the business of the retailer. In other words, if they can make the retailer a better merchant so that he sells more goods, they thereby make of him a larger buyer of their goods and a prompter payer of his bills.

A glance at the commercial mortality statistics will show how many retailers, especially in the rural dis-

tricts are in need of the help suggested. According to figures prepared by R. G. Dun and Co., there were in 1915, in the United States, more than twenty-two thousand commercial failures, with liabilities of more than three hundred million dollars. The significant fact in connection with the large number of annual failures is that about eighty per cent of them were directly due to the faults of the failing merchants. What these faults were, specifically, we shall see in a subsequent chapter.

Meanwhile, the question naturally arises: How can such faults be corrected, and how can dishonest dealers be eliminated as credit customers?

As a matter of fact, the deliberately dishonest dealer is rare. On the other hand, the hopelessly incompetent constitute a very considerable percentage of the smaller merchants of the country.

In the interest of sound business practice, the credit man should refuse credit to those who are incompetent, just as he should by every means at his disposal endeavor to make better merchants of those who tho inexperienced appear to be made of the right material.

More than a superficial knowledge of each dealer is required to draw the line thus sharply between good and bad. And even where there can be no doubt that a certain dealer is in need of help and guidance, there remains the problem of supplying such help in a way that shall prove effective without giving offense. Experience shows that if suggestions for the improve-

ment of their business methods are tactfully presented, the majority of retailers are willing to receive them. Accordingly, certain wholesale houses have made systematic efforts to learn in what particular departments of business their customers are deficient.

8. *A "business service" department.*—Typical among those who have carried this work farthest, is a certain New York varnish manufacturer which maintains a "business service department" under the direction of the credit manager. The object of the department, as stated by the manager, is "to help dealers in the conduct of their business by advice and counsel to avoid their going backward; to help them escape the courts; to avoid losing their money; in short, by suggestions and personal assistance, to help make them successful merchants."

The Company makes use of its salesmen in its effort to discover cases that require the aid of the business service department. Each salesman is provided with a report form upon which he checks the subjects which, in his opinion, demand attention in the case of the dealers reported on. This form is as follows:

Customer's name .....
Address .....
Business .....

I find this customer susceptible to suggestion and my observations indicate that he could profitably use the services of the department. I have x'd the points I consider applicable.

Accounting	Delivery Systems
Borrowing Money	Insurance
Cash Discounts	Legal
Cash Sales	Partners or Officers
Buying	Taxes
Collections	Trade-papers and Organizations
Credit	Miscellaneous
	Dealer's Credit Rating

The form contains a number of subdivisions of these heads, so that the salesman may indicate as nearly as possible what particular form of service he considers most necessary.

Upon the receipt of such a report, duly checked by the salesman, the credit man either visits the dealer in person or sends him a letter—preferably the former. At other times, when such a course seems desirable, the necessary information is sent to the salesman in the territory, who thereupon takes up the subject with the dealer by means of a personal call.

The department finds its services in demand chiefly in connection with such subjects as accounting, credits, buying and selling, insurance, taxation and legal matters.

9. *Direct value of cooperation with customer.*—Obviously work of this nature, when the credit department is in a position to give it proper attention, is of distinct value as a means (1) of developing the business ability of the more competent, thereby making them better customers and safer credit risks, and

(2) of tying these dealers more closely to the house that offers such service.

Mr. H. C. Workmaster, of Pittsburgh, writing in the *Credit Men's Bulletin,* of this phase of the credit man's work, says:

> Unfortunately the credit man who suggests such a policy is often met with the objection of expense; but my experience has been that I could secure enough business in addition to the valuable information I went after, to cover considerably more than my expenses, and besides being able to corral some overdue accounts which had stood as obstacles perhaps for several months to securing new business. One will be surprised at the number of "pick-up" orders that can invariably be secured in credit investigation excursions, orders which awaited the first man's arrival and which the customer had delayed in sending in.

Perhaps of even greater value is the information which by this means comes to the credit department of the wholesale house. In the words of Mr. Workmaster:

> A credit man has the golden opportunity of scanning with his own eyes the stock and character of the man with whom he trades his dollars, and is in position to note the actions and habits of the man in his own place of business. In many cases, by a little tact, it is possible to derive from him a statement of his financial affairs which can be compared with stock under direct observation. In not a few cases I have been successful in securing such statements after the representative for the reporting agencies had been flatly turned down. Why is this? It is not because more tact was exhibited, but because of the credit man's peculiar position. He is able to make the approach from a different angle.

Meeting the objection that many dealers would resent such an approach as an intrusion, the writer continues:

I have seldom left my customer with any but the best feelings, and with the exception of a few cases, I have been able to approach my people and handle their business after such a call, in a more friendly and intelligent manner. I have been able, very likely, to make a very small account a steadily increasing one.

REVIEW

What is the chief test of efficiency in the management of a firm's credits?

What should be the management's attitude toward the credit man with regard to authority in his department?

Define the credit man's proper attitude toward the sales department, pointing out two mistakes of opposite nature which he should especially guard against.

In his desire to protect the interests of his house, on the one hand, and to gain and hold the good-will of his customers, on the other, what general principles should govern the credit man?

With what departments of business should a credit man be familiar, and why?

What activities on the part of the credit man contribute to make him a constructive force in business?

CHAPTER X

CREDIT MANAGEMENT

1. *Essentials of organization.*—Back of the credit-granting authority there must be a "system"—an organization in the credit department of a business which is simple, accurate and as nearly as possible automatic in its operation. The building and maintaining of such a system for handling the routine of investigating, and checking orders is probably the most important thing the credit man has to do.

The character of the business as well as its size and the many local conditions that exert an influence upon it, will in a large measure determine the various details of such a system. The system for the credit office varies, even among organizations with similar problems to meet, and still more so among concerns which differ with respect to size, the number of accounts to be handled, the frequency with which purchases are made and the classes of customers who make them.

The ideal system is always the one that answers all requirements at the lowest operating expense. How it fits these requirements may be well tested in the results of a well handled sales or advertising campaign which brings down suddenly upon the credit department an influx of new accounts for which ad-

vance preparation must be made. A sudden change of marketing policy may put a strain on the credit machinery that will completely clog its working. It should be noted that while no system can function entirely independently of the personality of the man in charge of the credit department, there are elements common to all successful systems which can be taken as standard.

2. *Functions of the department.*—The functions of the credit and collection departments are (1) to pass on demands for credit and (2) to follow up for payments. For the purpose of fulfilling these functions every credit office must be equipped to handle data of two kinds (1) outside information, which reaches it continuously thru agency reports, the interchange of credit experience with other dealers, customer's financial statements and the like and (2) inside information which is gathered from the customer's ledgers, correspondence files and the records of the house salesmen and collection files. One authority has listed the necessary operations that the successful credit office must perform:

1. Record or have access to a record of all charges and credits for each customer.
2. On new orders received, either pass for credit, hold for investigations or refuse.
3. Make out invoices—file duplicates.
4. Handle and file all correspondence relating to customer's accounts.

5. Regularly follow up accounts falling due and remaining unpaid.
6. Keep other departments advised of condition of customer's accounts or changes in credit ratings.
7. Receive notice of all payments made so that the collection follow-up may be adjusted accordingly.
8. Be kept informed of complaints or demands for adjustments affecting payments.

Thus the details of operation calling for credit reports, the early steps of the follow-up, a large part of the routine correspondence and the charging and crediting of accounts can be performed on standard schedules. Broadly speaking, the test of a good credit office system is that it provides, with the least delay and chance of error, the information desired, and that it guards against mistakes and omissions on the part of the credit man himself by warning him automatically of dangerous accounts and of weakening customers. It will be of interest to see how this is done in the case of an ordinary wholesale house. The method described will not, of course, fit equally well every kind and condition of business, but it should, nevertheless, be suggestive as to the essential points to be covered by such a system.

Usually, the credit man begins his business day by examining the contents of the morning's mail. From this source he obtains considerable information

with regard to the state of collections without having to consult the ledger accounts every day. He sees, for example, what customers are taking advantage of cash discounts, and knows at once when a draft has been returned by the bank, uncollected. He also sees the receipt of new orders without having to wait for the reports that are sent in by the sales department and by other departments. At the same time, he is kept in touch with the latest news concerning business conditions within the trade, complaints of customers and matters of similar nature.

In admitting a new customer to the firm's ledger, the most important question concerns the credit standing of the newcomer. It is also important that the name and address be correctly recorded, and that a system be devised which permits all credit information relating to the new customer to be instantly available and so arranged as to serve as a guide for the credit man in passing upon subsequent orders from the same source.

3. *Requesting a signed statement.*—Frequently the information obtainable from outside sources is so meager as to be wholly inadequate for the purpose of granting credit. Frequently, too, the information at hand is too old to assure us that it accurately represents the credit-seeker's condition at the present moment. Under such circumstances, it may be deemed necessary to obtain a signed financial statement from the credit-seeker before the credit department can check the order. It is important, of course, that

a request of this nature be made as tactfully as possible, lest it should offend the recipient and cause the loss of a profitable customer.

If, on receipt of such a letter, the customer ignores the request for a financial statement, it is safe to assume that he has ample reason for withholding the information. Very likely he has something to conceal. It is safer, under the circumstances, that his trade be permitted to go elsewhere. If he sends a statement, the credit man proceeds to analyze it and bases his judgment upon such statement either with or without corroborative information.

4. *Handling new orders.*—On the arrival of a new order, the mercantile agency's rating book is first consulted in order that the rating given may be noted and the spelling of the name, the address, etc., verified.

The next step is to make out a triplicate "Notice of New Customer." These notices are padded successively in white, pink and yellow, or in any other three colors selected. They are worded exactly alike.

NOTICE OF NEW CUSTOMER

Business .....
Name .....
Town .....State .....
R. F. D. .....Ship'g point .....
Rating: Dun..... Brad.....
Remarks .....
.....
.....
Limit $.....(Sign) .....
.....19 Credit Manager .....

One sheet goes to the sales department, and shows at once that the order is from a new customer. If sufficient credit data are at hand the credit limit may already have been fixed, and will in that case appear on the sheet in the place provided for it. Where the credit limit is missing, it shows that an investigation of the risk is still being made. The information contained on this sheet is used by the sales department as a means of classifying the customer, and affords at the same time a basis for a letter acknowledging the order, or for whatever other correspondence may be called for.

The second sheet goes to the bookkeeping department. Its receipt is a warrant for the bookkeeper to open an account with the dealer named thereon. No new account is opened without authority from the credit department.

The third sheet remains in the credit department until the investigation is complete. Whatever additional information may be obtained is attached to this sheet, and the final limit is indicated. Thereupon the credit man's signature is affixed, after which the papers go to the bookkeeping department, where these later data are duly noted.

5. *Discrimination in credit-granting.*—If the credit-seeker is one who possesses means, even tho he lack present command of them, he is ordinarily entitled to credit at the hands of the merchant. No country merchant hesitates to extend credit to his farmer-neighbor whose growing crops, tho still un-

harvested, give abundant assurance of their owner's ability to pay his bills in due time. In the same class may be put the salaried person whose regular income is sufficient for his wants and who lives well within his means. Especially is this true if he is the head of a family and, as such, permanently located in the community. An unmarried man is regarded by the retailer with less favor as a credit risk. The same is true also of a married woman not legally responsible for her obligations.

The intemperate, the gambler, the manifestly incompetent, the shiftless and the idler are necessarily unworthy of credit favors and should be made to pay cash for their purchases. Persons suffering from an apparently incurable disease are also regarded ineligible as credit customers unless, of course, they possess sufficient means to assure the payment of their account even in case of their death.

A good rule that may be followed with perfect propriety in extending credit to "charge customers" is to put the burden of proof upon the credit-seeker. It is perfectly reasonable to assume that a person who desires to obtain a merchant's goods in exchange for a promise of future payment should be willing to state on what grounds he bases his expectation of being able to make the payment at the designated time. This is the principle upon which commercial credit is today asked and given. It should obtain equally where personal credit is sought.

6. *Understanding as to terms.*—In both retail and

wholesale credits, the amount of credit to be given and the date upon which payment is to be made are likewise subject to prearrangement. Once determined, these matters should be regarded with due seriousness. If they are not so regarded, it is generally the merchant's fault, in that he failed to impress upon the customer in the beginning the fact that he was expected to carry out to the letter his part of the agreement.

If the exact time of payment has been agreed upon in advance, it devolves upon the debtor, in case he becomes delinquent, to show cause why the amount is not paid according to agreement. Many merchants take the position of regarding the customer's payment of his debts as a favor, leaving with him the impression that such payment may be withheld if it is not entirely convenient to make it at the time it is due. This mistaken attitude is responsible for many bad debts and unpaid bills. A debt is always an obligation and must be so regarded by both parties to the transaction. If an extension of time is desired, it is the debtor's duty to obtain the creditor's permission for such extension. Payment cannot rightly be deferred without the creditor's consent. The principle applies to retail credits just as fully as it does to credits in a wholesale house.

7. *Holding the order pending investigation.*—In case an order must be held for lack of sufficient credit information, the carbon duplicate, before going to the sales department, is usually rubber-stamped "New—

Held for Credit." At the same time a notice is sent to the salesman informing him that an investigation of the customer is pending. This is done so that the salesman may be kept in touch with the progress of the order. When the information is complete and the credit limit is fixed, the salesman is again notified, in order that he may have opportunity to comment on the credit man's decision if he considers such decision unjust to his customer.

8. *Final disposition of the order.*—The investigation now being completed and all data desired by the bookkeeping department being duly entered upon the ledger account, the credit information is filed under whatever system of filing is used. For convenience sake, and as a check upon the correctness of the address, etc., an index card is made out. With a file of these cards at hand, the credit man is always in immediate possession of the salient points touching his customers. All further information relating to the present status of their accounts is, of course, readily obtained from the bookkeeping department.

When the card ledger system is used, an additional column may be provided to show the present balance, thus indicating at a glance the condition of the account. Places are also provided for the ratings and for the credit terms as well as for the data abstracted from the various credit sources that may have been used, covering the customer's character, capacity and capital. From time to time, this brief is revised or enlarged as new information comes to hand.

9. *Departmental organization problems.*—There are a number of points that may profitably be kept in mind as affecting the smooth operation of the office system. One has to do with the location of the department as closely as possible to the correspondence files, the accounting department, the complaint bureau or the sales department.

If the use of the ledgers by credit or collection department employes is likely to interfere too much with the bookkeepers or if these ledgers are too far away for easy reference it may be necessary to duplicate these records at a good deal of expense.

Since the back-bone of the credit department is its files, it becomes the problem of the man in charge not only to provide proper filing equipment to meet the needs, but to make sure that they are properly coordinated so that employes of the department can get along without referring to several files each time the records are consulted.

It has been suggested by one authority that any system would require at least four different files or access to them. (1) the customer's account ledgers, (2) agency report files, (3) invoice file, (4) correspondence file, which provide the necessaries of any credit and collection system; a record of the account, the follow-up and the assignment of routine work among members of the department.

The credit man, in addition to his responsibility for reducing a large part of the work of his department to a routine which will handle a vast amount of detail

without the need of his devoting personally any great amount of time to it, must make sure that the routine he adopts is as inexpensive as possible to maintain.

It will probably not be necessary or profitable to attempt to describe the physical equipment of the credit office or of the files. This is particularly true because the forms used for ledgers, card files, correspondence files and the like must in nearly all cases fit the individual requirements of the business.

10. *Standardizing the departmental routine.*—As fast as the procedure to be followed in the department for handling routine details has been worked out, it should be outlined definitely in the form of a departmental manual. In it should appear, in form of an organization chart or otherwise, the duties and responsibilities of every person in the department with the relationship of each to the department as a whole. This manual will of course be subject to constant change and revision and so should properly be on loose leaf suitable for use in a ring binder.

The routine operations that occupy the larger part of credit department work are probably the examination of the customer's ledger accounts and passing on customer's orders.

Analysis will show the number of accounts a clerk or a bookkeeper can examine within the periods between mailing schedule dates, so that there will be no slippage, waste of time or lack of attention to the follow-up.

11. *Departmental reports.*—As an actual gauge

of the effectiveness with which the department is being administered, nothing can replace the report submitted weekly or monthly in comparative form.

Some of the items that should be shown are:

1. Volume of orders passed.
2. Volume of orders rejected.
3. Volume of orders held pending investigation.
4. Percentage of losses to sales.
5. Volume of collections.
6. Cost per dollar of collecting.

Items which bear upon departmental activities in relation to the reserves for bad debts, expense of operating the department as provided in the budget, and others of the same kind are naturally to be included.

REVIEW

Describe the successive steps in credit and collection procedure.

What are the advantages of standardization in credit management?

Describe reports which can usefully be made of credit departments operations.

CHAPTER XI

COLLECTING THE MONEY DUE

1. *Determining the collection policy.*—Sermons on efficiency preached at and to business men of late years have hinged generally on one of two texts, "Increase your turnover of stock" or "Collect the money due you." From the first the injunction is drawn, "Keep your capital at work, not tied up in goods on the shelf," while the second leads to the advice, "Keep your capital at work for yourself, not for somebody else to whom you loan it without interest, for that is what you do when you fail to collect it."

The modern business concern takes a broad view of its collection function and does not confine it to the narrow limit of running down "dead beats" and grinding out statements of accounts to regular payers. The manufacturer, jobber and retailer of today gives careful study to his collection policy, to make sure that it fits logically into his marketing plan. Indeed, the seller's entire organization from president down to shipping clerk has a part to play in the distribution of his goods and in securing payment for them—the real completion of the sale. It is necessary nowadays to adopt policies for the collection department as clearly defined as those of any

other department in the business. All must harmonize with the general policy of the house.

The modern collection department has its part to carry out in the details of the marketing plan. At the same time it simplifies its own problem and enhances its dignity, when it endeavors to resell the concern's product and its service to the slow or delinquent or dissatisfied customer; when it seeks to stimulate in him the will to pay and the ambition to keep in good standing with the house.

In part these purposes can be accomplished thru helpful advice to customers who get themselves into difficulties. Time extensions are not the only aid that can be rendered. It is proving to be good business to stand ready to help constructively in the solving of marketing, financing or collection problems of the customers. Men, it is true, do not always keep their promises, but they keep them better when they are aided in so doing. Instances are multiplying of business concerns which have been helped to get back on their feet after periods of financial stress and which have later developed into extremely valuable accounts. In part it was due to consideration shown, but in still larger part, to the wish to help rather than to the effort to force payment, by the collection department. Such customers become the true friends of the house—and the collections problems, as far as their accounts are concerned, disappear.

2. *Putting the policy to work.*—The successful application of a broad constructive policy in collections

requires the same skill and forethought as the working out of sales, advertising, buying or credit policies. Haphazard or irresolute plans consisting of a few "schemes" may be out of harmony with the nature of the business or the reputation of the house. They will be inadequate.

Bringing in the money without making enemies or losing trade—the aim of every collection plan—depends for its success largely upon the tactful persistence with which the policy of the house, once determined, is carried out. A system which works with clock-work precision, massing the details of operating any collection office into groups for the purpose of standardizing operations, will produce collection department results at minimum expense.

3. *Need for a general house policy on collections.*—Obviously, if the collection function is to be exercised in anything like systematic fashion, if it is to be closely related to the business as a whole and is to have a direct effect upon the latter, it must follow a definite policy. This policy should be elastic enough to cover, by general rules, all the points which are constantly arising thru the contract with customers regarding collections.

Among the questions commonly raised in this way may well be those concerning terms offered. How strictly are they to be enforced? Will it be wise to charge interest on past due accounts? What shall be the policy when extensions are asked? Is it desirable to refer stubborn accounts to attorneys to collect?

Shall we exchange credit experience with others? Shall we accept cancelations and goods returned without cause?

4. *Making collections "constructive."*—It must be remembered that collecting money due the house is an important part of the marketing plan. Many business men make the mistake of approaching collection problems with something like distaste, with the feeling that they are conditions arising from some business malady, a necessary evil. Since no sale is complete until the money due is collected, this function of the business ranks with selling and advertising in the program of distributing a company's product.

The work of collecting is strongly affected by the work of the other departments of a business. If sales are forced and improper representations are made, collection is difficult. If new selling plans in new fields are launched, the collection plan must meet all contingencies. If the claim department bungles its adjustments, collections are held up and effort is wasted. If the manufacturing department has failed to maintain quality, collections may be slow or impossible.

5. *Building good-will thru collection methods.*—Successful collection effort must induce on the part of the customer the will to pay for what he has bought. If the customer can be impressed again with the same desire to possess the goods that originally impelled him to buy them, in spite of the interval between their purchase and their use or their resale, then there will

be no collection problem to solve. While the interval allowed in the form of credit extended may have dulled the buyer's original desire for the goods, or his conception of the profit to be made by reselling them may have weakened, it is possible by following correct collection practice to reawaken it and thus establish a resale.

Efforts to reinduce the buyer's original wish to possess the goods he has purchased, by appeals to his self-interest or his desire of gain, are at times fruitless, and the collector's effort must then play on the customer's habit of meeting his obligations, his natural dislike of wrong-doing and his fear of the law. In such cases, then, the collector is not selling the goods but rather the sense of obligation, the desire to do the right thing and freedom from worry or threat of legal action.

The process of reselling builds good-will; it fixes a continuity of interest with the customer and develops his account as an increasingly valuable outlet for merchandise. In applying the principle of resale the collector has open to him a variety of suggestions and appeals heretofore employed only in sales and advertising. The benefits of an effective collection effort are many. Among them are the reduction of accounts receivable, the rendering available of more capital to carry on the business, increased profits thru decreased expenses, a shortened credit period, conversion of delinquents to discounters and the establishment of a line of customers who are financially sound.

6. *What is to be learned from complaints.*—In a certain Pennsylvania store there was a clerk who kept what he called an "error book." In it he entered the "reasons why" when he lost a sale. In spare moments he went over the reasons he had jotted down and did what he could to prevent future losses thru the same causes. Here are a few entries:

Customer had to wait too long for change.
Did not have size collar in stock.
Goods asked for in stock room, customer would not wait.

The idea, developed further, proved valuable as a sales saver for the store and, because it put special emphasis on the importance of store service, it reacted to reduce complaints to a minimum.

There never was a business so well conducted in its relations with its customers that did not receive, at least occasionally, complaints which called for adjustment. In every business organization, then, some provision must be made, in the form of a "complaint department" or "bureau of adjustment," for looking after such matters. When a concern reaches the point where it realizes that every complaint received is evidence of a live customer at the other end, it begins to see itself as others see it, and it may find in its complaint bureau the most valuable gauge which could possibly be obtained of its value in the community.

Since every complaint, no matter how small or how unreasonable, has in it the germ of an excuse for the customer's delaying or refusing the payment of money due, to say nothing of his switching his trade elsewhere if he feels that his grievances are not properly righted, the collection man should be among the first to know all the facts.

In many instances it has been found best to put the responsibility of answering complaints and making adjustments in the hands of the same man who handles collections. There is much to recommend such an arrangement in the effort to prevent losses and to make closer collections. It emphasizes, too, the money value of handling complaints in such a way as to make friends instead of enemies.

7. *Classification of debtors.*—In the collection department, customers are naturally classified according to the promptness with which they meet their obligations.

The basis for any successful effort to collect money from a concern's customers is found in some accurate and as nearly as possible automatic means for separating those who pay promptly from those who are not quite so prompt; and those who show unmistakable evidence of being bad pay from those who are execution proof after having resisted all effort to collect. Obviously, if the procedure is to produce results, it must be different for each class. The big advantage for the collection manager of classifying debtors, lies in the close and accurate knowledge of his

accounts that is thus made possible. Because they are broken up in groups with similar tendencies, he is able to study them to better advantage and apply the treatment which is most needed.

With such a classification completed and rigorously maintained, he is enabled to handle a much larger number of accounts than would otherwise be possible. While there will always be debtors who will require special treatment, the larger number of delinquent accounts, in the groups thus classified, can be handled by means of a fixed routine, and the work which is guided by a definite policy can be entrusted in a large measure to the assistants in the department.

8. *Good pay.*—Obviously, any customer is considered good pay who does not let his account lag into the "past due" class. He pays voluntarily on or before the due date or with reasonable promptness after his account becomes due. Such customers require the minimum of attention and expense and it is naturally, perhaps too hopefully, assumed that all new accounts accepted for credit will belong to this class. They are so rated until there is evidence of a contrary nature.

The delinquent classes are recruited from among those who once were "good" and hence there is a definite responsibility on the collection manager to go over his good account files constantly to see that any slipping backward tendency is promptly checked. Many times a good paying customer is allowed to neglect his account until it reaches a point where the

amount is beyond the debtor's power to pay promptly. When this occurs, the customer enters the "slow pay" class which comprises those who "fully intend" to pay their debts but who for one reason or another are not able to do so promptly because of poor management or seasonal conditions or some other circumstance beyond control. Sometimes the collection manager is himself responsible for recruiting the slow pay class from among the "good pays" because he misjudged the customer on the credit department's facts or failed to follow him properly, with the result that the money which should have gone to pay his concern's account has been expended elsewhere.

9. *Slow pay or on "probation.*—Slow pay customers are frequent in rural trade where buyers depend upon the crops for their income and pay their debts when the harvest is ripe. Such debtors might perhaps be better classified as "deferred" because while they are perfectly good, they pay in their own time.

Another subdivision of the slow pay class is made up of those who are honest, whose intentions are the very best, but who thru miscalculation or unexpected demand or misfortune are unable to meet their payments as they fall due. Such debtors require very careful treatment. Unless the collection system provides for properly nursing such accounts back to normal by careful study of the facts and some arrangement for small payments, the losses are likely to mount up, not alone in money but also in good-will and potential business from customers who might

have been helped back into good financial condition by the right kind of cooperation.

It is no uncommon thing to find among these slow pays, debtors who, while being perfectly good, make it a part of their business policy never to pay until they are forced to do so. They reason that the longer they can keep the money in their possession the longer they will have the use and benefit of it. While they do not ordinarily go so far as actually to stand suit, they often go to a point just short of that.

10. *Delinquent or bad pays.*—The next class of debtors in degree of difficulty of collection comprises the "bad pays"—the really hard up and unfortunate, the gamblers or "shoe string merchants" who are good for the amount and who pay at the last moment but who have no regard for their credit standing and who should never have been trusted, as well as the professional dead beat.

The dead beat has been described as a post graduate of the school of extravagance. The percentage of dead beats is much higher among married men than among bachelors. People of the dead beat class never pay any attention to demands from the collection department. They are rarely accessible to the collector and if they are discovered by accident they are profuse with many promises which are as easily broken as made. The only hope with debtors of this class is to follow them so relentlessly that payment finally appears to them the lesser of two evils.

11. *Execution proof.*—Under the classification

"execution proof" may be placed the residuum from all other classes—the accounts which have defied all efforts to collect and which, because the debtors own no property, cannot be forced to pay thru resort to legal action. These are the accounts that are written off at the end of the year. To some extent they represent the failures of the credit and collection departments since it is here that the mistakes of both are buried.

Taking risks on the integrity, the trading ability and the financial sense of the dealer customer is an essential part of the manufacturer's or jobber's selling. Holding the risks down without hampering the sales force is the job of the credit man with the help of the collection department. In order that the business may profit by mistakes in the past and prevent them in future dealings and that it may correct possible wrong tendencies in credit and collection policies, it is suggested to every credit and collection department that a periodical inventory of collection losses—analysis and close study of this residue of charged off accounts—may be well worth while.

If each case is studied with the salesman at regular intervals to determine what caused the trouble as well as how it might have been detected in time to save the dealer and keep the house from loss, much can be learned about holding the proper balance between safety and maximum volume of sales.

Such an analysis may show that the loss was inevitable because the customer lacked fundamental

knowledge of store management—location, financing, right buying, relation of mark-ups to cost of doing business, and the like. It may show the error to be that of the credit man for not detecting this weakness or that of the collection man for failing to note it and for not coming to the rescue with help and cooperation to off-set the handicap and thus save the account.

12. *Planning the system to carry out the policy.*—If results in any appreciable volume are expected from the collection effort, they cannot depend wholly upon the personal skill of the collection manager. More important is the extent and thoroness with which he is able to develop a routine system for handling the details of his work. The essential benefit of such a system is the planning and arrangement of the work in such orderly fashion that the accounts will be promptly and automatically brought up for attention and a record of each collection step recorded until the final payment is received.

There are a number of lesser points of routine policy which must be decided upon, as, for example: Shall we use sight drafts? If so, how soon in the follow-up? Shall we use form letters, a printed statement and reminders only? How long should we allow between follow-ups? What use shall we make of advertising or inspirational inclosures with bills? Shall we suggest trade acceptances? If so, what sort of educational campaign do we need to introduce them to new customers? The list is not intended to be exhaustive, merely suggestive.

When the general policy and organization of the collection department has been established and the system under which it operates has been properly worked out, the man in charge can delegate a very large part of the detail operation of the department, such as filing cards, posting reports, handling routine correspondence and initiating the follow-up, to trained assistants. It should be particularly noted, however, that these very details are much more important than they may seem and that the assistants in whose charge they are placed must be everlastingly watchful and accurate.

A collection system is not something to be installed and successfully operated in all its details without change or adaptation. Usually it is the result of gradual development—changes and improvements introduced here and there as new and unexpected needs arise.

If there is no carefully planned system for handling collections, one which is geared to the general policy and growth of the concern using it, there is a resort to haphazard methods with the usual outcome, haphazard results. There will be delays in noting delinquencies, costly mistakes in handling customers' accounts and general demoralization and loss from uncollected debts.

It is obviously impossible to outline any one collection system that may be fitted exactly to the needs of all business. While they are all devised with the same end in view, they must differ in details accord-

ing to the nature of the business served. The chief requisites common to all, however, are simplicity, accuracy and economy of operation.

13. *Effect of trade usage on collection policy.*— Habit, the instinct that decides a man to act successively in the same way in response to the same impulse, is perhaps the most valuable ally of the collection man. Habits or precedents granting certain terms and conditions of payments are developed in certain lines of industry no less definitely than habits are formed in individuals. Thus trade custom or usage arises. Sometimes it may be extremely desirable for collection purposes to change these customs, but it presents a very difficult problem to do so.

Some explanation of the variation in credit terms in different lines of business has already been given. We have seen credits varying from 30 days to 60, 90 days, sometimes 4 months, and in seasonal lines thru the system of post dating, even for six or nine months.

These periods are imbedded in trade usage and are well-nigh unalterable. Because of this the collection policy must obviously be carefully planned to take such special conditions into account. Obviously the consumer or the retailer will favor the manufacturer or jobber who gives him the most favorable terms. In the same way he is inclined to resent any attempt to change established habits of paying unless he can be shown some advantage to compensate him for doing so.

REVIEW

What should be the relation of collection policies to general house policies?

How may complaints be made fruitful in developing business methods?

How does the collection man classify debtors? Describe the several classes.

What effect does trade usage have on collection policy?

CHAPTER XII

THE COLLECTION MANAGER AND HIS WORK

1. *Personal characteristics.*—It has been suggested that "A credit man should be of an investigative turn of mind, and should have an agreeable yet indomitable obstinacy." This is also a happy combination of qualities for his Siamese twin, the collection man. An investigative turn of mind indicates caution, deliberation, vigilance and sagacity, while agreeableness, courtesy and respect are affirmative business-building characteristics. These virtues, when tempered with obstinacy, produce the positive qualities of a good collection man.

Since the responsibility for collecting accounts due the house is closely related to that for accepting the account in the first place as a reasonable risk, it is often found merged in a single head credit man. If the collection manager is not a credit office assistant, but an independent official, he should work in the closest harmony with the credit office. He should be able to command its facilities for gathering information and to utilize its records, in order to bring about the prompt payment of money due.

On the average, only ten per cent of total losses occur before accounts mature. This fact helps us to realize how important is the work of the collection man

since to him falls the responsibility for handling the remaining ninety per cent of the cases so that actual losses after accounts mature are reduced to a minimum. Generally speaking, his results are accomplished thru his patience, insistence and persistence.

All men are not equally qualified for collection work. Some personal characteristics among these qualifications assist their possessors materially. Some are acquired thru experience; others are the gift of nature. Among the latter, perhaps the most valuable is an even disposition, one that is not likely to betray its owner to sudden loss of temper or despair of collecting a difficult account. Sympathy and imagination are almost prime essentials. If the collection manager shows interest in the debtor's troubles, if he wins his confidence and thus induces him to talk, the chances are that, based on the information obtained, an arrangement of some kind can be made for payment of the debt. Sympathy cannot of course be allowed to degenerate into weakness. When information cannot be gained directly from the debtor himself, the collector with an imagination can place himself in the debtor's position, and by utilizing his own experience and his knowledge of the many methods by which payments are made, may be able to suggest a plan by which the debtor can meet his obligation.

Of the qualifications that may be acquired, the first importance must be given to the ability to judge human nature. If this power were perfectly developed, the science of collections and credits also

would be an easy one to master. The knowledge of human nature—knowing beforehand what people are likely to do under given circumstances—comes with experience and from contact with others. In handling collections, however, too much reliance cannot be placed on one's unsupported judgment of human nature, nor must appearances be given too much weight, for they are often deceptive. Facts and figures, certified, where necessary, by a public accountant, form a better basis for credence than good clothes and a plausible manner.

Courtesy, a most essential qualification for successful collection work, is, we believe, one which any one can acquire. While it is obvious that the collection man must not feel himself bound to accept any excuse, and while he must not fail to press his claims properly, nor weaken in his demands for what is due, courtesy must, however, control his manner and expression no matter what his action may be. Sometimes a harsh, threatening and overbearing manner is necessary, but such tactics are always dangerous unless the collector is sure of his ground. They arouse antagonism on the part of the delinquent, repelling him when otherwise he might have made a settlement. On the other hand, more people, debtors included, are likely to respond in kind to good treatment accorded them, and many a debtor has been shamed into paying a debt long due solely because of the courtesy and decent treatment shown him.

A good collector is therefore courteous but firm.

He collects closely and in doing so makes it impossible for lagging debtors to lapse back into delinquency again. If the collection policy adopted by a concern drives customers away for no other reason than because they take offense, then those in charge are open to the suspicion of unfitness because they fail to sense the need of courtesy.

Patience and persistence are two more qualifications important in the make-up of the successful collection man. The delinquent must be persistently followed and patiently attended if his habits of carelessness and neglect are to be overcome. Many an account has been hopelessly lost as a result of quick, hot-headed action. In the same way many accounts actually given up for lost and charged off to profit and loss, have been turned into money thru an exercise of patient persistency by the collector. Patience is often rewarded because the financial condition of individuals changes as time goes on. The account that is uncollectable today may be perfectly good six months or a year from now. When the time comes, if the debtor knows that the collector is still after him he will often settle voluntarily.

2. *Relations of collection to credit department.*— Collection work is sometimes done directly by the credit department, sometimes by an independent department. However organized in any particular case, there are of necessity very close relations between credit work and collection work which should be clearly understood.

If credit granting were an exact science and a credit man could be found who was infallible there would be little need of a collection department, either under his own charge or in charge of another. No matter how carefully credits are checked, mistakes will be made, misrepresentations made will secure credit that should never have been granted, or conditions will change after credit has been granted. In any such case careful collection effort is necessary to salvage the account.

The preparation for collecting should be made at the time the account is opened. Information can readily be obtained at that time, and as it may be needed later in collecting the account, nothing which may be pertinent should be neglected. Definite knowledge of the customer's financial status will not only enable the credit man to decide upon the credit to be given and the limits to be set, but will also help the collection man to judge from the facts the causes of delinquency and to decide upon the best method for handling the collection. In addition to the information gathered at the time the account is opened, it is most important for collection purposes to provide facilities for keeping thoroly posted on all events and developments possibly affecting accounts. Business failures; deaths; marriages, when the accounts of unmarried women are affected; fires; floods; financial disturbances; all these and many other events may affect a customer's paying power and should be promptly noted.

With such events in mind, it is not sufficient that the collection man simply lock the barn after the horse is stolen. As a part of the constructive service which he is able to render, he should be enough of a student and an analyst to look ahead and to anticipate the probable reaction from strikes, floods or wars, so that he may be ready armed for any emergencies. Thus, by adopting counter measures, he helps to neutralize the effects of disorders and disasters and minimizes the losses which flow from them. Assuming that the credit department's preliminary investigation has been thoro enough to establish a customer's right to credit according to the standards of character, capital and capacity, the collection man's job is to keep his ears close enough to the ground to detect the faintest indication of lapses from satisfactory standards and to act accordingly.

3. *Making use of credit office machinery to assure collection results.*—If it is essential that the credit man make use of all possible sources of information at the time when he is judging an applicant for credit, the collection man needs an equally free hand to use all these sources when it comes his turn to handle the account. Credit department files reveal to him the statements furnished by the applicant at the time of opening the account and at intervals afterwards. Reports of salesmen calling on the trade, sent more or less regularly to the credit files, should be open to him for reference at all times. The privilege of calling for special reports on doubtful customers thru the

commercial agencies or banks or thru local bureaus and the interchange of information and experience offer quick sources of information just as vital in importance for the collection of accounts as for opening them.

One of the most useful sources of information on customers for later use in the collection of accounts should be the house salesmen. The value of this kind of information, however, has not always been appreciated. For example, one credit man had the right idea when he explained to his house salesmen that the most helpful things they could tell him about a retailer were the things which enabled him to picture the customer when writing a letter to him. Is he a big, heavy man with sandy hair and a hearty laugh, or is he small, thin and dark eyed? The same information that helps a salesman to size up a customer in making a sale, will help the house in making collections. Some houses even make it a practice to collect photographs of their customers and their places of business because they find them helpful in handling their accounts from a distance.

4. *Organization of collection department.*—The answers to the question, "What is a hundred per cent efficient collection manager?" vary about as follows: The board of directors would consider him "one who collects one hundred per cent of the indebtedness shown on the books." The sales manager would say he is "one who collects without killing future business." The rank and file salesman would define him

as "one who forgets overdue accounts." The real definition, however, as collections are viewed in modern business concerns, would be "one who collects, yet creates good-will and paves the way to greater yearly sales by making a purchaser into a better customer."

Probably in seven cases out of ten the collection man who is responsible for sending out statements and writing letters to slow or delinquent accounts is the credit manager's assistant; collections are then considered as part of the credit department's work. In such cases the responsibility for both credit and collection initiative and policy is centered in a single head. In other concerns the two functions are entirely divorced and organized as two separate and distinct units with a head for each department responsible for the performance of his own particular function.

The advantage to be gained from such a division of function is more apparent in a large organization like the city department store, where there are thousands of accounts constantly being opened and where in the same way there are always thousands of accounts to be followed for payment—enough work to keep one man busy. Another advantage of a separate collection department is to be found in the constant and independent check provided on the work of the credit man, whose judgment in opening accounts for credit is constantly being put to the test when they come to the actual payment of accounts.

5. *Responsibility.*—Whether the collection man is

classed as a sub-department head who reports to the credit man as the really responsible head, or whether he is accorded the dignity of an independent department, the responsibility upon him to produce definite, dollars-and-cents results cannot be dodged. Furthermore, the results which he must produce bear a very definite relation to the amount of money tied up in accounts past due and to the definite amount appropriated on the basis of past experience as the limit of cost per dollar collected beyond which the concern cannot afford to go.

Restricted on one hand, therefore, by the credit policy of the house which passes upon the risks which may be accepted, and on the other hand by the collection costs, it is no light task for the collection man constantly confronted by emergencies resulting from fires or floods or crop failures producing conditions that no one can foresee, to show consistent returns in money collected. Yet that is exactly his job.

6. *Training for the work—special and general.*—While it is possible to state the qualities which are desirable in the "ideal collection man" in a general way, the training which will develop these qualities is a matter on which a good deal of thought has been expended without reaching conclusions or generally accepted standards.

In addition to his technical knowledge of collection psychology—the character, instinct, likes and dislikes, desires, ambitions, habits of thought and action peculiar to people who buy on credit and the knowledge

of how to induce action, the collection man needs a working knowledge of law and of his company's market, its product and policy.

One concern took the preliminary steps in the training of its collection man when it asked him to deliver a package to a small city hardware dealer and to find out why the latter's overdue account had not been paid. Having delivered the package and having secured a promise to pay, he found that the dealer simply didn't know what to do, first to get and then to hold trade. By means of suggestions drawn from a knowledge of good merchandising methods, the collection man helped to change that hardware dealer from a prospect for the sheriff to a merchant who discounted every bill.

By the time this man had learned that nine times out of ten when a retailer failed to pay promptly the latter may have thought he was getting square for some grievance against the creditor's house, he knew the retailer's real problem was to be found in his own business methods. Where the manufacturer or jobber finds his retail customers falling behind in their payments on account, the creditor's first step should be to find out in what ways the retailer is a poor business man.

After two years further experience, one as a traveling collector for a hardware jobber and the other as a salesman for the house, this candidate for the job of collection manager came to know every excuse for deferred payments so far invented; the sick wife, the

lost check book, the failed savings bank, the dishonest partner, the delayed payments on sales to the city and the thousand other inventions of the delinquent retailer.

The number of men who offered such excuses, however, he found small as compared with the ones who said "What am I going to do? This business is going down hill. I'd pay you, but if I did, I'd starve. You'll get your money as soon as I get a little ahead of the game."

In this situation the skillful collection man finds that he needs a knowledge of store finance and the lines and quantities a store should carry, since to get a retailer debtor to pay promptly it is often necessary to show him how to figure costs and make profits.

REVIEW

What are the qualities of a good collection man?

Why should the collection man be closely associated with the credit department?

What are the arguments for and against his being a subordinate of the credit man?

What are the responsibilities which a credit man undertakes?

How may men be trained for collection work?

CHAPTER XIII

PRINCIPLES UNDERLYING COLLECTION EFFORT

1. *The debtor's motives.*—When passing on applications for credit, it is recognized that all obtainable information about the customer should be made a matter of record. It is important that the collection man study this information on the customers of the house, that he acquaint himself with their habits of living, of buying, of paying, of thinking. Consciously or unconsciously, he comes to be a student of other people's motives, an expert in the reasons why men do or think certain things under given circumstances. The more exactly the collection man can reduce to definite principles the motives which actuate people who owe money, the more successful will be his efforts to induce the settlement of their accounts. From many possible steps, the collection man must take the one which will be most effective under given circumstances. Experience has shown him the power of habit, the importance of securing and holding attention, the value of appeals to instincts and ambitions to which nearly all men respond automatically, and the value of suggestions which bring the desired reaction.

From earliest times, human motives for thought

and action have been substantially the same. Among the more common ones are reactions from hunger, cold, self-defense, pride, love, enjoyment and alleviation of suffering. Certain ideas or impressions relating to each of these are firmly planted in our minds thru long custom and use. The merest reference to them will awaken associations and memories that stir us powerfully. The mind is stored with memories of acts we have performed because of our interests in our health, our homes, our families, our success or our desire to make or to save money.

As a consequence, even the suggestion of these interests moves us powerfully toward action. Open discussion, which may arouse opposition, is sometimes less effective than indirect suggestion, because action often follows without the realization that we have responded to any stimulus outside of our own minds. In such instances we feel that we have acted chiefly on our own initiative, and would perhaps be astonished if told that we had been skillfully persuaded to act.

Hence the collection man, having studied the general mental operations of the man who is asked to pay a bill and having discovered the usual trend of his thoughts, will work with it rather than against it. Next he studies his customers to see whether there are any special motives to which they are likely to respond and which he may use in the process of securing payment. He examines the relations between the house and the customer to ascertain if possible

what fixed impressions have been established in the customer's mind after months or years of business dealings. These will relate to such things as values in goods, prices, service, accommodation and credit.

If an honest review of the customer's relations shows that the true values of these things are not well established in the latter's mind, the collection man determines that he will implant them there by selling to the debtor in good earnest, pride, savings acquisitiveness, competition, initiative or patriotism. Having done that thoroly, there is no need to sell or induce negative states of mind like fear, shame, or the desire to avoid annoyance.

2. *The right mental attitude.*—Before an appeal can be made successfully to any one of the varied motives that may be involved in the payment of a debt it is necessary to know what kind of debtors one has to deal with. Where there are many thousands of accounts to be handled this does not appear to be an easy thing to accomplish. Yet by the simple process of grouping debtors into classes according to the degree of promptness with which they make payment, he is able to judge approximately which appeal will be most desirable. Having completed the process of classifying debtors by the promptness or the slowness or the chronic delinquency of their payments, the process of applying persuasion or pressure to induce payment begins in each group according to its place in the collection scale.

For those customers who are always prompt to

take the discounts for their purchases, no more than a formal statement of account or a mild reminder of the obligation is required. But to those who by habit are inclined to take the full limit of terms offered, it may be advisable to add to the statement a letter which will convey just the right touch of friendly reminder of the account. To those who appear to be heading perilously near to the slow pay, careless or dead beat class, the appeals will probably be changed from pride, acquisitiveness, competition, or initiative, to fear or apprehension of consequences as most likely to bring results. The poor pay customer is not easily frightened, because he is callous by nature, or indifferent thru experience, so that ordinary collection appeals leave him unmoved. The collector who understands this type of mind and who can outgeneral it and surprise it will be able to score success where others fail.

Frankness without bluster, swift and determined advance from stage to stage of collection procedure with occasional appeals to self-interest and pride, together with a steady pressure for payment, will do much to convince the callous-minded delinquent that he has met his master and that further resistance will be too expensive to risk. It is no more difficult to use these appeals in correspondence than in interviews. The collection correspondent must write much as he would talk in such an interview, except that he will be much more brief.

3. *The personality back of the appeal.*—There is

added attention value and a more distinct impression on the mind of a sales prospect when a series of sales letters are varied in form and appearance. Collection results are likewise affected by variation in the type and appearance of the collection appeals. The unadorned invoice or statement of account, for example, because it emanates from the bookkeeper's desk, typifies the mathematical accuracy of the creditor's accounting record and gives an impression of regularity and routine. Such formal statements and letters typify the house in its general, impersonal relation to the customer and so produce a certain definite effect.

When, in the cases of customers who for any reason are in trouble and cannot pay, letters bear the signature of the collection manager, a different effect is produced because of the authority vested in his title. In the same way an appeal to self-interest or an offer of service or of leniency from the president of the concern or from some one obviously in a position to grant favors is likely to carry weight and influence which would not follow an ordinary letter.

Similarly an appeal to a delinquent's pride coming from an attorney or a collection agency or from some one obviously outside of the creditor's immediate organization will prove less effective than the same appeal from an officer of the concern to which the money is actually due.

Generally speaking, on this very account, except in desperate cases the advantage lies entirely with the

house which makes its own collections, because the usual outside collector, accustomed to deal chiefly with tough cases, is in most instances a poor diplomat.

4. *Value of repetition.*—The basis of a successful system of collections is the constant reminder of the debt—the repeated suggestion that payment is due and must be made. The constant repetition of the idea is in itself often sufficient to induce belief. The debtor who has been forgotten by his creditor, or who has for any reason failed to receive notice of his indebtedness, very naturally in his turn forgets the debt. On being suddenly requested to pay, his mental attitude is one of surprise. The first impulse is to deny the debt. Having denied it, the next natural step is to refuse payment. In such a case it is necessary to persist in suggesting to the debtor that he owes the money, since it is logical for that suggestion to become a conviction and a spur to payment. A forgotten obligation offers an easy basis for beginning operations. The object is to occasion in the debtor's mind a gradual remembrance of the debt, and ultimately an absolute conviction of his duty in the matter. In almost every case where the debtor denies the obligation, he does so from force of habit, but since he has denied it, the constant suggestion that he still owes the amount must be depended upon to bring to him sooner or later the conviction that the bill must be paid. Under the gradual yielding to suggestion the debtor who at first denied his debt will sooner or later be seeking a valid excuse for qualify-

ing his original denial. It is best then in presenting the forgotten bill, to go on the assumption that it will be denied. It is proper, therefore, to request the debtor to give a reason why the bill should not be paid. This allows him to make the natural response that he does not owe it. Then on being pressed again for reasons, after the collection man has answered his objections, he frequently begins to qualify his denial, thereby making ultimate recovery much easier.

Constant suggestion of even an obnoxious idea, will sooner or later occasion in the debtor's mind either some doubt as to the validity of his objection or the apprehension of trouble. That is why persistent dunning wears down objection after objection. The debtor cannot maintain an attitude of absolute indifference in the face of repeated suggestions. In the case of an honest obligation, he feels that he has either to pay or to fight. The more persistently the suggestion is made, the less marked will be his belligerent attitude, and the more likely his conviction that he is in the wrong. Accordingly in making the initial demand, a loophole should be left the debtor to qualify his denial, so that eventually he may back down and pay without any appearance of humiliation. The psychological moment will come when some newer creditor will cease to remind him of a more recent bill which he owes and should pay. If at such a time the insistence on payment of the old account is constant and forceful, the debtor will suddenly

pay to have done with it. Constant reminders will break down almost any denial or refusal.

5. *Need for salesmanship in collecting.*—Much of the success of collection effort depends upon the manner in which the constant reminding or dunning is done. The successful collector finds use for all the persuasion, logic and diplomacy that would be found necessary if he were selling goods instead of collecting for goods already sold. As a matter of fact, his work is that of selling and reselling to the forgetful and neglectful customer a sense both of his old obligation and of the advantages of keeping his reputation good in his creditors' eyes. Obviously, then, the letters which emanate from the collector's domain are really selling letters. They must keep the customer's interest in mind, and consider his business experience and his education.

Especially for the collection of petty accounts where the amount involved will not permit much outlay for collection expense, and in the cases of slow and careless but "good" accounts where it is necessary to cajole the customer into paying, bringing the matter to the attention of the customer is the most important step in the collection procedure. A letter that is personal in tone, naturally receives more attention in such cases than the bald statement of the debt. There are many devices in common use for lending attention value even to formal statements of account. Explanations of terms printed in red, "stickers," or pasters to go on the invoice urging

prompt payment serve the purpose. Variety in the form of the collection appeal with an eye to the surprise value of "stunt" letters will sometimes bring results that would be impossible from an unbroken series of plain but colorless requests for payment. As with sales letters, however, there is an objection to the overuse of freak letters or collection devices in that they are apt to attract attention to themselves and not to the action desired.

6. *Utilizing the power of habit.*—Perhaps the most valuable aid to successful collection is habit. Actions at first induced by suggestion or initiative, eventually become habitual by repetition. A habit once formed is apt to be stronger than any first action likely to follow a certain stimulus. What a man has done once, he is likely to do again under the same provocation. A debtor who has once paid an account is more likely to pay again and again, than is a new debtor to begin making payments. For this reason the debtor who after a period of delinquency has begun to pay should be watched closely to keep him in the paying habit. It is necessary that the collector induce him to confirm this habit into one that cannot easily be broken.

In the case of accounts where payments are to be made in instalments, definite suggestions must be made as to the exact time and circumstances under which the next succeeding payments will be expected. He must not be permitted to neglect that date since to do so will break a mental thread in the debtor's mind. The habit should be fed and encouraged by

unfailing suggestion to impel payment of some amount on every date when an instalment is due. The debtor should never be allowed to put off a payment on the ground that he hasn't as much money as he had promised to send. The collector should insist on receiving some part of the amount at least, even if it is only a fraction of the sum expected. If the debtor is allowed to put off a single payment by a promise of a double payment next time, the payment habit is broken and the putting-off habit has been started.

It is just as important for the collector to acquire the habit of making regular demands for promised payments, as it is for the debtor to be induced to make them. If the former cannot habituate himself to regularity in a matter so important, he cannot in fairness expect to induce regularity in those whose delinquency occasions the need for his services.

7. *Appeals to the emotions.*—All collection appeals find expression either in *obligation* or *advantage.* Obligation is kept skillfully in the background during the earlier collection procedure but assumes a more and more prominent place in the follow-up. Pride, either personal, local or sectional; self-interest, thru the resale of credit or goods; savings, expressed in the desire for discounts allowed, or profits; good-will and cooperation, all these serve the collector's purpose.

The suggestion that payment should be made can be reenforced by appeals to the emotions, and those which may be drawn into play may be noted.

Appeals to good nature or to the customer's sense of fairness are commonly used midway in the collection procedure, just as it begins to assume a sterner cast and passes from the emphasis on the customer's advantage to that on his duty. In a class by themselves are the appeals to shame or to fear or the wish to avoid trouble.

One of the most treacherous emotions likely to confront the collector is anger. It will develop oftentimes as a result of no conscious suggestion by him. He will never arouse it intentionally unless he is perfect master of himself—of his own emotions—and unless he is able to recognize the psychological moment for action when the emotion of anger in the debtor has spent itself.

8. *Knowledge of the debtor essential.*—It should be plain that any attempt to describe the exact methods that may be used in applying the principles developed must be futile. These depend in a measure upon the knowledge which the collection man has of the particular debtor with whom he is dealing. Unless he has all the data available which give him an accurate mental picture of his delinquent's habits and characteristics, the work is likely to be perfunctory and ineffective. He should have at his command all the facilities of the credit office machinery, the cooperation of his concern's sales people, the analysis of the customer's past records. With such materials there is no real excuse for the failure of a capable collection man to get information.

The results from his efforts are never in doubt because they are shown in hard dollars and cents. There is no room for theorizing about them, they are the definite and immediate proof of his success or failure in collection work. There is much variation in business and great difference in people's habits and their reactions because of differences in localities, conditions and customs. Even tho principles developed from a vast amount of collection experience may be stated here, skill and judgment on the part of the collection man will always be required to insure their successful application.

REVIEW

Why is it important for the collection man to know as much about the debtor as possible?

Discuss the effects which are supposed to follow from formal and from informal demands for payments?

How does the collection man utilize the customary mental effects of suggestion, repetition and habit?

What is meant when it is said that salesmanship is essential in collection effort?

CHAPTER XIV

COLLECTING ON A FRIENDLY BASIS

1. *Advantage and obligation.*—Two ideas, as has been noted, underlie the whole fabric of the collection system. First, it is to the customer's "advantage" to pay what he owes; and second, he has a definite "obligation" to pay. It follows then that the easiest approach to the delinquent is thru the friendly avenue of "advantage." It may be assumed that most men who buy on credit fully intend to pay. When they do not pay it is because when the time comes they haven't the money; because their plans have miscarried, or because other and more attractive uses for their money have arisen. Thus their conceptions of the advantages to be gained from carrying out their original agreements are dulled.

Obviously, it is the height of bad collection policy to emphasize too soon or too strongly the idea of obligation without first finding the real cause of nonpayment and making sure that every possible effort to secure a settlement by milder and more friendly collection methods has been tried and proved fruitless.

2. *Need for getting at the causes of non-payment.*—Since it may be assumed that all men want to do what is right if the doing is not going to prove too

inconvenient or entail too much of a sacrifice, the collector begins his work by seemingly taking for granted that payment will be made when it is due. On this principle the preliminary steps in all collection systems take the form of reminders and formal statements which cannot possibly be construed as reflecting in any way unpleasantly on the customer's intentions.

When as time goes on some still fail to respond, it becomes necessary for the collection man to find out the causes for the delay. To get at the reason for non-payment is the chief purpose of the collection follow-up to those who have failed to respond to the first bill.

3. *Stages in collection procedure.*—In general, it may be said that collection procedure divides itself into natural steps thru the friendly stage where the debtor's account is presented to him from the viewpoint of his advantage. They are: (1) notification; (2) reminder; (3) reproach; (4) discussion, and (5) resale.

4. *Notification stage.*—In many concerns the invoice covering goods purchased is considered sufficient notification to the customer, and if it is not heeded the procedure is likely to develop swiftly to the draft and the unpleasant stage of collection.

The notification may take the form of a simple statement of account which is timed to reach the customer exactly on the due date. In other cases it is the practice to time the mailing of the statement long

enough ahead of this due date to reach the customer five or ten days before the account is payable so that he may get his remittance in to the house on the due date. In such cases it is customary to print on the statement some such notice as this: "Your account will not be due for ten days. This statement is sent for your convenience."

It is not uncommon practice to inclose with such notifications a printed folder or a blotter which carries a message of interest or inspiration and which by its appearance and general get-up will attract favorable attention to itself and thus bring the account unfailingly to notice. One wholesaler of food products in New York City varies the interest in such a series of folders by selecting for them subjects like "Hints for Effective Stock Arrangement," "How to Figure Turnover," "Savings Effected by Taking Discounts" and many other topics of the class designated "dealer helps."

5. *Reminder stage.*—It is fair to assume that when reasonable notification has been given and the payment is not received when it is due, the obligation may have been overlooked. It is not safe to suggest that the oversight was intentional, even in cases where it may be suspected that the delay was more deliberate. It is at this stage that a customer begins to classify himself as a prompt or a "slow pay" and it is particularly important that every tactful means be used to present the account squarely to his notice without giving any grounds for his taking offense. Conse-

quently, the mailing of bills or statements marked "Second reminder" or bearing stickers calling attention to terms, must be strictly impersonal and always courteous.

6. *Offer of concession.*—The offer of a cash discount is primarily intended to induce payment. The fact that a customer has failed to take advantage of it by the time his account reaches the reminder stage would seem to suggest the futility of opening any further concession. In some lines of business, however, where the discount is not prevalent, a concession for immediate payment is sometimes effective. In such cases the house pleads that a special emergency requiring cash makes it willing to settle the debtor's present indebtedness for a sum sufficiently below the full amount due as to make the proposition attractive. When this is done, as in the case of instalment houses, for example, it gives the collector a new argument offering a benefit to the debtor. The "money saved" argument, however, has no weight with the dead-beat debtor, who is trying to avoid payment of the whole amount; nor is such an offer suitable for most commercial houses because it sets a bad precedent.

7. *Discounting notes.*—A bank can often secure payment of a claim where an individual or firm cannot do so because the bank has a semi-public position which gives it greater weight and authority in the eyes of the debtor than is accorded to individuals or ordinary business concerns. If, therefore, a claim is in the form of a note, or can be placed in the form

of a note, and this note is discounted or deposited with the bank for collection, it is more likely to be paid than if carried in the form of an open account or presented by the creditor in the form of an invoice.

This is equally true of the trade acceptance or the acceptance draft. By reason of his endorsement of the instrument the customer has acknowledged his liability for the amount in question. It is frequently possible to secure a note or an acceptance in settlement of an account when, at least at the time, it is absolutely impossible to secure cash. If the note or the acceptance passes thru a bank for discount or collection the chances for payment are much better than if the indebtedness remained in the form of an open book account.

8. *Reproach stage.*—After the reminder stage, the next logical collection step deals with accounts which still fail to respond with payments or to offer any reasonable explanation of delinquency. This stage in the collection program may be called, for want of a better word, the "reproach" stage. Here brief typewritten or multigraphed letters begin to replace printed notices. The letters begin mildly to appeal to pride and the sense of obligation. Any formula that "resells" the value of the credit privilege extended or that tends to awaken anew the sense of duty to pay, comes into use at this stage. Not infrequently, this phase of the collection follow-up is ushered in with the use of bright colored stamps or labels pasted on the statement bearing such legends

as "Have you forgotten us?" or "Please," or "Statement of July purchases. Balance upon our books for purchases prior thereto. Please verify and report any error on this statement."

9. *Acceptance drafts.*—The ordinary sight draft as it is commonly used would not properly belong in this stage of the procedure unless it was very tactfully introduced or unless the traditions of a particular line of trade had made it customary.

The sight draft should be reserved for a later point in the collection procedure because it is not transmitted direct from creditor to debtor, but is sent thru the medium of a third party, the bank. To many a customer the bare idea of permitting a bank, whether his own or some other, to know of his indebtedness is extremely distasteful, and he should not be exposed to it until later when his neglect of the account more nearly justifies such action.

There is, however, an adaptation of the draft idea which is suitable for use in the stage of collection under consideration because it avoids the objections noted. It is the "acceptance draft," which is nothing more or less than the regular sight draft form sent direct by the creditor to the debtor, without passing thru the bank's hands, with the suggestion that the customer endorse his acceptance on its face and return it. Used in this way the device serves as a very effective notification of the obligation, and if accepted, supplies a bankable instrument which satisfies the claim.

10. *Sight drafts.*—While the sight draft is nothing more or less than a request for money that is due, its value in the collection process lies chiefly in the fact that it is not transmitted direct from the creditor concern to the debtor, but thru the agency of a bank. The bank which performs the service of presenting a sight draft may be one in which neither party has an account but simply acts as a collector. In the relations of the manufacturer or wholesaler with his dealer customers, where the drawing of a draft is an accepted practice at this stage, it is common to draw it thru the customer's own bank for the convenience and with the full consent of the drawee.

In cases where collections are to be made from difficult debtors it is better to arrange for the draft to be presented thru a bank other than that at which the debtor transacts his own business, because a strange bank is not so likely to favor the debtor by unduly holding the draft. Occasionally, a bank friendly to the debtor will hold a draft for weeks, or until the drawer has traced it to discover its disposition.

11. *Follow-up drafts.*—In cases where the creditor's draft is returned unpaid, a second draft may be sent out immediately and will occasionally produce results. There should be a letter from the creditor mentioning the first drawing, and taking it for granted that neglect of it was due to some misunderstanding on the debtor's part. This is desirable, first, because it gives opportunity for some straight collection talk, and second, because it prevents any misapprehension

on the debtor's part. The second demand and the letter will also impress the debtor with the creditor's intentions. The effect of his dignified persistency is increased by sending the second draft thru a different bank. Then the debtor feels himself hemmed in on all sides, and, being uncertain as to how far this process may be carried, foresees the effect on his credit—if he has any.

12. *Telephone calls.*—Somewhere between the reminder and the reproach stage there is an opportunity to make good collection use of the telephone for local or short distance claims. The telephone call is a comparatively mild measure, not to be trusted in really difficult cases, because the debtor may so easily cut off further argument or urging to pay by simply hanging up his receiver. For an ordinary slow account and for the purpose of getting a debtor definitely located, however, it is often as effective as a personal interview. When the creditor's message urging payment comes over the telephone from an officer of the concern, it may even be more effective than an interview with a mere collector for the house who at best is only a subordinate. There is one weakness in the use of telephone collection calls—the money cannot be secured then and there. The debtor's mind may be brought to the paying point and the collection man may, of course, suggest sending for the money at once, but if this is not feasible or not acceptable to the debtor, he must await the remittance.

For collection purposes, it is well to remember that

there are certain difficulties also in proving telephone conversations if the occasion should later arise requiring such evidence in a legal action. A person who attempts to prove a telephone conversation with another must, for example, be able to prove that he has previously talked face to face with that person and be able to swear that he would know the voice and recognize it when he heard it over the phone. The fact that most voices do not sound the same over the telephone as in ordinary conversation is a feature that must be considered in proving such telephone conversation.

13. *Registered letters.*—When a delinquent pays no attention to letters and is not accessible to personal calls or telephone communications, the registered letter may occasionally be used to good effect. In the letter one often calls attention to the fact that other letters have not been answered, or states the condition of the account, and any other details or circumstances which may assist in the collection.

The effectiveness of the registered letter is due to its semi-official character. Registry is formal and unusual. When the delinquent debtor receives a registered letter in reference to his account, he will, in most cases, conclude that the matter is becoming serious. He knows that the letter was registered and that he has signed a receipt for it, but he does not know why this was done, or what use is to be made of the receipt. His imagination is then apt to prove a valuable ally for the collection manager. It is al-

ways a distinct point gained when a delinquent debtor can be brought into personal touch and to a formal recognition of the fact that his debt exists; and this a registered letter will, in most cases, bring about.

14. *Telegram.*—In any written communication relating to an indebtedness much care must be taken to avoid liability under the laws against libel and blackmail. Anything written is "in black and white" and if it goes beyond the limit of the law, the sender has himself supplied proof for his own conviction.

This caution is still more imperative with regard to an open communication, such as a telegram, than with a letter, for here the lines are much more closely drawn. The telegram is, in a sense, public property, and about all that can be safely contained in it is the inquiry, when may the remittance be expected. It is interesting to note that the Western Union Telegraph Company in certain of its circulars designed to promote the more general use of telegrams in business has suggested a long list of messages which may safely be used in the collection of accounts without overstepping the bounds prescribed by law.

If used at the proper time a telegram is often very effective, general tho its wording must be. Perhaps a special letter has been written strongly urging payment of the account in whole or in part. The telegram may then be used as a follow-up, tho in form, perhaps, merely a reminder, such as "Wrote you on the 25th. When may we expect a remittance?" or something of that sort.

In many cases a telegram undoubtedly does have the desired urgent effect. The fact that it is ordinarily used only for emergency business gives it greater weight than other forms of communication. The cost is small, and if there is any prospect of its producing results, it may well be tried.

15. *Discussion stage.*—Assuming that as the result of efforts expended in the notification, reminder and reproach stages a reasonable percentage of the slow and delinquent accounts needing attention have classified themselves by either paying or explaining, the fourth stage of collection procedure—that of discussion—is reached for such claims as continue to resist all efforts.

At this point the handling of the account will ordinarily be removed from the routine of the department and be placed in the hands of the collection man himself. His immediate object will be to find out "what's the trouble?" Where he has decided upon the measures necessary to apply at this stage, he will take pains to explain to the debtor exactly why he is taking them, in order to give proof that he is fair, even tho severe. His object is to put the debtor on the defensive in any discussion of the matter which may be provoked.

The chief object of the discussion stage is to draw out some sort of an explanation of the delinquency, if not a payment of the account. If a reply is received it is comparatively simple to decide what to do. At this point the collection man gets a real

chance to show his skill in the curbing of delinquency and the straightening out of misunderstandings or difficulties of all kinds. With all the records before him he can size up the debtor and then determine what the collection procedure shall be from that time on. Naturally, if the record of an account gives a hitherto undiscovered clue to the possible explanation for its condition, it will be useful at this stage.

16. *Defective remittances.*—Knowing that the habit of nonpayment grows from small beginnings, the collection man is keen to pick up any trifles which for one reason or another interrupt the regularity of payments on schedule time. He is, for example, suspicious of defective remittances. If checks or exchanges are received without proper signatures or endorsements they must ordinarily be returned for correction and so are conducive to bad payment habits.

Cases occur when such defective remittances have been made with deliberate intent on the part of the remitter. He anticipates that when the omission is discovered his check will be returned to him for signature or endorsement; that he can hold it a day or two before returning it, and that he will thus gain the time consumed in transit and the time that the check is in his hands. The total interval in the case of far-distant points sometimes aggregates between two and three weeks.

It may prove to be wiser at times not to return such a check for signature. If it gets back into the sender's hands it may be a long time before it comes back

again, and in any event a delay cannot be avoided. As an alternative, the check may be deposited with the depositor's guarantee, or with a request to the bank to forward the item for signature and collection. The customer from whom the check was received should be informed by letter of the situation and of what has been done. In due time the check will arrive and be presented to the drawer for signature and payment. It is seldom that a concern or an individual of any credit standing will refuse, in such cases, to sign.

The following courses of procedure have been found effective in dealing with defective remittances:

1st. In cases where check is not inclosed in the letter, make a draft for the amount specified, pin it to the letter, deposit them in the regular account and notify the debtor why draft is made.

2nd. When checks are wrongly made out, write on the back over your signature "amount guaranteed," mentioning the correct amount, attach the letter and deposit.

3rd. When the check is not signed, write over your signature "within amount guaranteed," attach to the letter and deposit.

4th. When checks or drafts to the remitter's order are not endorsed, examine the letter carefully and supply the endorsement yourself as agent, and deposit, retaining the letter as your authority to do so.

In suggesting this last method it is assumed that, under the conditions stated, authority is clearly given.

17. *Writing to the debtor's business acquaintances.*—When a delinquent refuses to answer com-

munications but is known to be still in the same location, and the creditor concern has or can secure the addresses of business or personal friends, references or connections of the debtor, it is sometimes very helpful to intimate to him that, if no response is received to its letters, the concern will write to one or more of these persons, merely, of course, to secure information of the debtor's whereabouts. This will often bring a reply, but if it fails to do so, it is then entirely permissible to write to any one who may be in a position to help, explaining that the delinquent is indebted to the concern, that letters written to him had received no attention and asking for information as to his whereabouts. This procedure may bring a certain amount of pressure to bear upon the debtor which will lead to payment of an account. It may happen, also, that friends or relatives will pay such an account themselves rather than allow the matter to become public, and this is especially likely when the debtor has resorted to underhanded or fraudulent means of evading payment.

18. *Tracing moved debtors.*—One of the problems of every collection manager is to trace debtors who move about frequently and who forget, purposely or otherwise, to give any notice of such intention to move, or to leave any information of the new address.

Almost any method of tracing demands concealment of motive. It is futile in attempting to get information regarding a "skipping debtor" to tell his

friends or neighbors that you have a bill against him and you would be obliged to them for information leading to his address.

Inquiries made of neighbors and nearby business houses, banks or concerns with whom he was known to be doing business should produce results. A man who has lived in a neighborhood rarely leaves it without having formed some acquaintances or connections, business or otherwise. The object of the tracer is to find these connecting links. Those acquainted with a debtor are willing to do him either a good or a bad turn if properly approached by one acting in the capacity of an investigator into the debtor's credit. Many men leave disgruntled and dissatisfied acquaintances behind. Their reports are as full and complete as the reports of those who are friendly to the debtor and who wish to give him a good character. Both usually give voluntarily the present or possible address of the man sought.

19. *Tracing thru National Association of Credit Men.*—Probably the best means of country-wide tracings of debtors is afforded thru the medium of the National Association of Credit Men and the pages of its monthly *Bulletin,* which lists the names and the particulars of persons wanted. Circulating as the *Bulletin* does among thousands of credit men all over the country, it is possible for a creditor in one section of the continent not only to secure information regarding delinquents who have "skipped" but at the same time to warn others against the possibility of

themselves becoming involved with them in the same way.

20. *Tracing thru the post office.*—There is a postal regulation, Sections 551 and 560, Postal Laws and Regulations of 1893, which supplies a useful means for tracing lost debtors.

Under this regulation, the creditor may provide himself with a rubber stamp, to be used on the face of the envelop containing his message to the debtor, which reads like this:

POSTMASTER

See Sections 551 and 560, P. L. and R. 1893
Give reasons returned.
Check one of the following reasons:
Refused
Unclaimed
Cannot be found
Present address unknown
Removed to

Ordinarily the letter carrier or post office will give little information regarding the forwarding address of any one who has moved, because it is against the postal laws to do so. Registered letters will not bring back a receipt from the person sought unless the face of the envelop bears the words "Receipt Requested" and then it does not contain any definite information as to the address at which delivery was actually made.

While the postmaster cannot legally give the change of address of any one, yet, if a collection manager's mailing list for a given city is sent on to

him for the purpose of correcting addresses, he is permitted for a fee of 40 cents an hour for clerical labor involved to correct such a list. In this way it is often possible to locate persons who would otherwise never be found.

21. *Reselling stage.*—When the procedure of collection enters the "discussion" stage it also enters almost simultaneously the "reselling" stage except in the cases where thru some special urgency, it seems advisable to press matters quickly to the "unpleasant" or final measures.

It must not be assumed that all effort to "resell" the delinquent should be confined to this one particular point in the collection process, since every step in the whole process of collecting, from the formal statements to the transfer of the account to an attorney should be saturated with good salesmanship.

The reselling effort referred to here does not, moreover, concern itself directly with the goods purchased or with their quality and desirability. It centers itself on the debtor with the purpose of making him feel ashamed of his own neglect by overwhelming him with the evidence that he has failed to play the game altho more than fairly treated. It is proper to call this the reselling stage because, after visualizing all the debtor's circumstances as revealed by the records and credit files, it applies human, personal and direct efforts to sell him a sense of obligation.

Business houses generally have learned that it does

not pay to drive blindly ahead at this stage to more strenuous action without pausing, first, to make sure that the case against the debtor is complete. This is made more advisable because of the heavy turnover year by year in trade which is driven elsewhere because of some house policy that may have failed to take all the circumstances into account. Once having decided to press matters to a conclusion, it is obviously out of the question to revert back to a milder or more conciliatory attitude afterward.

At this stage, then, the collection man's personality, his sympathy, his imagination, his knowledge of business conditions generally and his understanding of them as they may affect the individual debtor must come into fullest play. In the process of handling an account during this stage, the collection man may make use of all the devices common in earlier stages if by so doing he feels that he can get results. Sometimes the reselling effort will take the form of earnest constructive suggestions, hints for improvements in a customer's business methods or practice. Many times when such plans have been proposed and then followed consistently the customer has been able to work out his own salvation, with the result that he becomes an everlasting friend of the house which helped him in his trouble. The building of good-will resulting from such reselling efforts richly repays the pains and efforts taken.

REVIEW

In requesting payment what two main groups of motives can be relied upon?

What are the usual stages in collection procedure, and what is the significance of each?

Describe the various ways in which drafts can be used.

What rôle may telephone and telegraph play in collection procedure?

How are defective remittances handled?

What can be done when the debtor ignores all requests for payment?

CHAPTER XV

UNFRIENDLY STAGES OF COLLECTION

1. *Advisability of going to last extreme in collecting.*—In spite of the efforts expended to effect a settlement of all delinquent accounts thru the collection stages which have been characterized as "friendly," every business house has to deal with debtors who for some reason or for none at all refuse to pay any attention to the various invoices, statements, drafts or letters designed to bring about a payment or to elicit an explanation with a promise to pay. These cases call for more strenuous treatment than any that have gone before and the collection man must then decide how strong will be the pressure he can afford to exert and how it is to be applied.

He realizes that when accounts must be followed to the last extreme of unpleasantness to secure payment, even tho the money is finally collected the active animosity of the debtor himself must be incurred. The result, moreover, may be the loss of further patronage and also of good-will if this debtor has any following or influence in his neighborhood and trade. It is also certain that the cases which will not lend themselves to settlement, except on the imminent threat of legal proceedings or of legal action itself, will entail

an actual loss of time and money and this may be greater than the amount of the debt involved.

Considerations, however, outside of the actual collection of the money due, sometimes make it necessary for the creditor to push the matter to its logical conclusion as a matter of principle.

2. *Final stages of collection procedure.*—When it is assumed that all reasonable efforts to bring about the settlement of an account thru an explanation of unusual circumstances which may have delayed payment have been resisted, no choice remains but to enter the final stage of collection procedure. Even here the collection man's purpose is to get at the underlying causes of non-payment, and in doing so to force the delinquent into the position where he must pay or explain if he would avoid the inconvenience and the expenditure of time and money which he knows will surely follow legal action.

3. *Black lists.*—Appeals to the fear of consequences from continued neglect are conveyed in the form of veiled or open threats of action to follow. Such threats, however, must be used with the greatest caution or they may defeat their own ends and involve those who use them in most unpleasant consequences.

A common form of conveying a collection threat is that which explains that as a member of a trade or credit association the creditor is required to report all slow and delinquent accounts in order that other members of the association may not suffer loss thru

credit granted to the same habitual delinquents. Such a threat is well within the collector's rights because that is the common practice among cooperative associations offering legitimate protection.

Because he realizes that his account has been neglected without any reasonable excuse, the debtor is usually quick to see the disadvantage of having his name so listed among slow pay customers. This is particularly true since he does not know how wide a circulation such a list may have.

4. *Offering debtor's accounts for sale.*—A practice followed by associations of retail merchants in some localities is to list names, addresses and amounts due on the accounts of all delinquents in the community and after sending out two warnings by letter, to offer the accounts for sale. This plan has been found to work very effectively in New Orleans, where it has been declared legal under the statutes of Louisiana.

5. *House collection agency.*—Assuming that it is necessary to threaten legal action unless the amount of the claim, long past due, is not paid, it behooves the collection man to prepare himself to carry out his threat.

There is a distinct advantage, however, in retaining control of such claims as long as there is the least chance of last minute repentance and payment. It is quite customary, on this account, to threaten quick action by a collection agency or an attorney, but instead of actually referring the claim at once to an outside collection agency, to instal for the immediate

purpose an agency of the creditor's own, whose office is in the company's collection department. Such an agency, as far as the delinquent is concerned, has all the appearance of an independent organization devoting itself to the collection of difficult accounts, bringing legal action and performing other work of that kind. Suitable letterheads and stationery are prepared. A brief new series of letters is written with care to make them altogether different in phrasing and appearance from the house letters the debtor has been accustomed to receive.

The following is quoted from such a letterhead of a house agency to show how the letterhead may serve to throw disquiet into the heart of the delinquent. This was printed across the bottom of the sheet:

> Confidential reports of all bills handed us for collection, giving the names and addresses in full, to protect merchants from giving credit to irresponsible parties who are making no effort to pay their honest debts, are furnished by us daily to merchants and professional men in ———— City and County.

Care should be taken, however, not to overdo this sort of thing to the point where the debtor may suspect its genuineness.

The advantage of the house agency lies in the fact that a certain percentage of these "last ditch" accounts will be brought to time by the business-like display of the intention to use force. This means a saving to the house in collection fees and time. A still greater advantage lies in the fact that such cases,

if once rescued, may by careful handling be revived and even entirely redeemed and reinstated to good standing.

6. *Final notice before suit.*—It is customary to devote the third or fourth letter in the house agency series to a "final notice before suit," which will mark the real limit to the debtor's chance to avoid legal action.

Sometimes this notice takes the form of a semi-legal document drawn to represent, in the eyes of the uninitiated, a formal summons to pay. The use of a form even remotely resembling legal phraseology or arrangement is to be avoided. It is doubtful whether it is any more impressive to a delinquent customer, who has the intelligence to see behind its mask, than a brief letter, crisply phrased, to the same purport.

7. *Utilizing the bad check laws.*—It is to be expected that in dealing with any number of delinquents whose accounts have brought them this far in the collection procedure there will be found among them now and then those who have given checks that are later returned by the banks marked "N. G."

It should be noted in passing that thirty-nine of the states now have on their statute books laws dealing very definitely with the debtor who knowingly gives a bad check.

A very effective way of utilizing the law covering such cases has been worked out by collection men and collection agencies who print the text of the statute on cards suitable for inclosing to a debtor who has

offended by way of forceful reminder that he is treading on thin ice.

Such a presentation of the Tennessee law is shown here:

HOUSE BILL 148

A BILL to be entitled "An Act making it unlawful for any person to obtain money or other property or credit by check, draft or order which is not paid by the drawee, and where the same is not refunded or restored by such person on written demand mailed to his last known address; and making the fact of such person not having on deposit with the drawee such money or other property, prima facie evidence of said fraudulent intent."

SECTION 1. Be it enacted by the General Assembly of the State of Tennessee, That any person who shall obtain, with fraudulent intent, money or other property which may be subject of larceny, or who shall obtain credit with like intent, by means of a check, draft or order, of which he is the maker or drawer, which is not paid by the drawee, shall be guilty of a misdemeanor if the amount or value is thirty dollars or less, if the amount or value is more than thirty dollars he shall be guilty and punishable as in case of larceny of such money or other property, or of anything of value obtained on such credit, unless payment of such check, draft or order after giving seven days written notice mailed to the drawer's last known address, and the fact that such maker or drawer did not have on deposit or to his credit with the bank, person, firm or corporation upon which such check, draft or order is drawn, sufficient funds to pay the same when presented, unless such check or draft is paid or accepted when presented, shall be prima facie evidence of fraudulent intent.

SECTION 2. Be it further enacted, That all laws and parts of laws in conflict herewith be, and the same are, hereby

repealed, and that this Act take effect from and after its passage, the public welfare requiring it.

Passed May 12, 1915.

Wm. P. Cooper, Speaker of the House of Representatives.

Albert E. Hill, Speaker of the Senate.

Approved May 15, 1915.

Tom C. Rye, Governor.

8. *Selecting an attorney.*—When the time comes for actually referring claims to an outside agency or attorney for collection, it is well to remember that it will still be possible to secure settlement of a considerable number before it is necessary to actually bring suit.

Most of the effectiveness of handling a claim thru an attorney or an agency lies in the fact that the debtor, having become familiar with the house collection policy, finds himself suddenly in the hands of a stranger. Most people are uncomfortable in unfamiliar surroundings. If the same collection letter, instead of being written on the house letter paper, were to be written on that of an attorney, it would be much more pronounced in its effect on certain delinquents because of the unfamiliarity and hence the dread of the unknown.

Thus in somewhat the same way the dread of uncertainty makes the idea of a court action immediately threatening, oftentimes more effective for those who have never been thru the ordeal of a court action, than the action itself is to those who are case hardened by previous experience.

The very fact that by far the greater number of claims which are turned over to attorneys or agencies are actually settled without suit, makes it doubly important in selecting the legal representative to pick men who are amenable to the client's suggestions, who are willing to work with the house collection man and keep his policies always in mind. It may be argued that the attorney or agency should be allowed to follow his own methods, regardless of what they may be, since he is likely to fail if he continues to apply methods dictated by the house policy. In the long run, however, it will be found that the attorney who consistently and intelligently keeps the house policy in mind will do better work and make fewer enemies for the house than the attorney who insists upon a free hand to follow his own plan.

Attorneys and collection agencies include a number of those who are eternally talking "suit" and seem to have no other tricks in their bag. Such men should by all means be avoided as incompetent, because no concern can afford to have its collection man in court any oftener or any longer than is necessary. Experience has shown that court action should not be necessary except in comparatively rare instances.

Some collection men feel that once they have turned an account over to the attorney for collection the matter ends there, as far as they are concerned. This is a mistake, because after all the account still belongs to the house and the attorney is at best only an integral part of the collection machinery.

It may seem too obvious to mention that before selecting the attorney or the agency to entrust with his claims the collection man should make a thoro investigation of his reliability, and his ability to secure the desired results, and of his methods of doing business.

The irresponsible collector may be so slow in paying over the money which he collects that the client will have to resort to criminal proceedings before he can be forced to disgorge. An unscrupulous collector can often do his work in such a way as to result to his own personal gain and to the client's disadvantage, yet not make himself responsible for his misdeeds in either the civil or the criminal courts. Some collection agencies and bonding companies offering attorney lists furnish to each client a surety bond indemnifying against loss thru embezzlement. This appears to be a greater safeguard than it really is. An examination of such a bond will generally show that the entire liability of the surety is limited to a few thousand dollars. Should such an agency be doing an extensive business and prove dishonest it might very easily misappropriate a much greater sum than that for which the surety is responsible. Divided among a number of defrauded creditors each one in this case would recover only a very small percentage of his loss. Hence it is far better to investigate the reliability of the collector in advance, and to guard against possible future trouble by refusing to place business in the hands of one concerning whose integrity there can be any question.

In most localities there are attorneys who specialize in the collection of commercial accounts and who are well qualified to give prompt and efficient attention to claims placed with them. Young attorneys, men recently graduated from the law schools, whose practice is still to be built up, are often found to get better results in handling collections than older men of more seasoned and more varied experience. The younger men need the money and the practice and have a name to make for themselves. For this reason they will often follow collections more closely than is usual with older law firms, which may prefer to devote themselves to other lines of legal work.

9. *Using attorneys in other cities.*—If the claims which are to be referred to attorneys are not merely local but arise in various towns and cities over the country, the problem of handling them takes on new difficulties and complications. In such cases the collection man usually finds it necessary to subscribe for the service of one or more of a large number of attorney lists or directories published by various agencies and bonding companies, and which give the names of attorneys located in practically every town or city on the continent. As already explained, as a part of the service which he purchases, the collection man is protected, to a degree at least, by the bond of the publisher from mishandling or misappropriation of money collected by attorneys whose names are so listed. Under this guarantee he may forward his claim to any attorney on the list.

In order to make the guarantee operative, the following procedure is necessary:

1. See that the attorney selected is named in the current revision of the "Guaranteed Attorneys List" which is usually revised by means of supplements issued monthly thruout the year.

2. Attach a letter of advice to each claim sent to the attorney designated, notifying him that the forwarder is protected by the publisher's bond.

3. Notify the publisher's home office at once on a "Bonding Notice" of the date of forwarding each claim, giving particulars.

A specimen of the "Bonding Notice" mentioned is shown here:

BONDING NOTICE.—
Send this to the Home Office of the U. S. Fidelity & Guaranty Co.
DEPARTMENT OF GUARANTEED ATTORNEYS.
AT BALTIMORE, MD.

..... No. .....
Attorney
Address ..... Date .....
City *State*

CLAIMS VERSUS	LOCATION	AMOUNT

UNITED STATES FIDELITY & GUARANTY CO.,
DEPT. OF GUARANTEED ATTORNEYS,
Baltimore, Md.

We have this day forwarded for collection the above described claim to said attorney, on the faith and by reason of his name appearing in the latest revision of your "Guaranteed Attorneys Quarterly." This notice is a compliance with the requirements of your Bond which we hold.

.....
City.....
State.....

DRAFT DRAWN BY A HOLDER OF THE BOND OF THE

UNITED STATES FIDELITY AND GUARANTY COMPANY

DEPARTMENT OF GUARANTEED ATTORNEYS

Total Resources, over $10,000,000 — Home Office, BALTIMORE, MD.

$..... 19

With Current Exchange

At.....sight, Pay to the order of the.....Bank of

.....the sum of..... *Dollars,*

With Current Exchange

Value received and charge to account of

.....

Drawer

To ....

Debtor — No. — Street

Address ....

City — State

G. A. Form 258

PATENTED IN THE U. S. JULY 21, 1914

262

SUBJECT: DRAFT ON

.....

Debtor

OF.....

.....

We take the name of your Bank from the "Guaranteed Attorneys List" of the United States Fidelity and Guaranty Company, Baltimore, Maryland.

DRAWER'S INSTRUCTIONS TO BANK

(To be torn off before presenting)

Gentlemen:

IF OUR ATTACHED DRAFT *on this debtor* IS PAID AT MATURITY, *please* REMIT PROCEEDS *direct* TO US, THE UNDERSIGNED DRAWERS THEREOF, *and* NOT *to the United States Fidelity and Guaranty Company.*

IF DRAFT IS DISHONORED *on presentation* OR IS NOT PAID *at maturity, please* PROMPTLY DELIVER *or mail it* TO THE ATTORNEY NAMED ON THE REVERSE HEREOF.

We enclose stamped envelope bearing attorney's name and address.

$.....

With Current Exchange

PLEASE SEE OTHER SIDE

DO NOT PROTEST

263

STATEMENT

DRAWER'S INSTRUCTIONS TO ATTORNEY

NAMED IN LETTER TO BANK

Dear Sir: Payment of our annexed Draft having been refused, we, the undersigned drawers thereof, hereby authorize you to take prompt action for its collection on the terms stipulated on the back hereof.

Promptly acknowledge receipt and advise what course is best to pursue. Wire, if in your opinion the circumstances warrant.

Do not make any compromise nor receipt debtor in full for any partial payment. Remit all money collected direct to the undersigned by P. O. Money Order, Bank Exchange or Express.

☞DO NOT DETACH FROM DRAFT

Drawer's Instructions to Bank—*Continued*	Memo. for Bank
Please deliver to	..... Drawer
..... Attorney	..... No. Street
..... Street	..... City
..... No. Bldg.	..... State
..... City State	..... Date

TERMS STIPULATED FOR THE COLLECTION OF THIS CLAIM BY THE ATTORNEY:

To the Attorney: We hand you this claim, through the Bank named in this Draft, on the faith of and by reason of your name appearing in the latest revision of the Guaranteed Attorneys List of the UNITED STATES FIDELITY AND GUARANTY COMPANY, and give you notice that we hold said Company's bond. We have notified the UNITED STATES FIDELITY AND GUARANTY COMPANY that we have placed this claim in your hands, as required by the conditions of said Company's bond. *Your agreement to the terms here stipulated is hereby made a condition precedent to any performance on your part and will be evidenced by your retention of this claim.*

1. Without Suit. 15% on the first $300.00 or less collected.
8% on the next $700.00 or less collected, and
4% on the balance collected in excess of $1,000.00.
Minimum fee, $5.00.
If the claim is for less than $10.00—50% of the amount collected.

2. By Suit. Suit must not be instituted by you without our authority. If suit is authorized, we will advance all court costs; and your compensation is to be a non-contingent suit-fee of not less than $7.50, plus the commissions hereinabove stipulated on the amount collected. If the fee for suit is more than $7.50, it shall not exceed the local customary fee for similar services. In no case, however, is the suit-fee plus commissions to exceed half the claim.

3. If this claim is for goods sold and delivered, and it is settled by our consenting to a return of all or part of the goods charged in the

invoice thereof, your compensation for obtaining such goods is to be as hereinabove stipulated, except that, for the purpose of calculating your commissions, the goods returned are to be regarded as worth only 50% of the value at which they are invoiced to the purchaser.

4. No service justifying any charge other than the foregoing will be begun without notice to us that such service will be undertaken. For such service the charge shall not exceed the local customary charge for similar services.

5. If in your locality, collection fees or rates are established by law or by the rules of a Bar Association, and we are so notified, such law or rules shall govern.

6. No extra charge shall be made for obtaining notes or other security for this claim, if we allow the notes or other security to remain in your hands for collection.

7. If this claim is settled or paid direct to us after an effort by you to collect, you will be entitled to the compensation herein provided for.

8. No charge shall be made by you for unsuccessful efforts to collect, except as herein provided for.

To facilitate suit, if authorized by us, we beg to say that our firm is composed of .....

We are a corporation under the laws of the State of.....

.....

In some cases the publisher of the bonded attorneys list provides for certain preliminary collection steps before actually referring the claim to one of its attorneys. For example, if the creditor who has subscribed for their service cares to try the effect of a draft on the debtor thru a bank also named in the list, he will fill out and mail to the bank the instructions shown here. The duplicate mailed at the same time to the debtor carries a letter addressed to him in the upper section instead of the instructions to the bank.

10. *Using a third party to "forward" claims.*—In cases where there are only comparatively few claims to refer to out-of-town attorneys the details of looking after them properly can probably be handled

easily from the creditor's own collection department. Where there are a large number of claims to be dispatched over a wide range of territory, the work of looking after the details may very well assume considerable complexity.

With a view to rendering a very useful service to the collection man by relieving him of the bother of handling such details, certain organizations known as "forwarders" have been organized and are operating with much success.

The forwarder offers the collection man an opportunity to place all his out-of-town collecting in the hands of one who makes a specialty of receiving and forwarding such items. It is the plan followed by many of the larger concerns who do not have an expert collection handler in their own organizations. Such a specialist must be an expert collector himself. He will be in close consultation, by letter and by wire, with the collectors he employs locally whenever he has claims to handle. Thus his client has the advantage of two experienced men working on each claim at approximately the same cost as if the collection man dealt with the attorney direct. Such a forwarder is familiar with the various legal directories, and knows how to pick out the best local collectors. He probably has had other business in the same locality in which the money is owed and the chances are that he will have on his own list the name of a local lawyer there of whom he knows that he can handle the business properly.

He has learned by experience how to force local attorneys to keep him fully informed of the progress made upon work assigned to them, and if his own office is conducted in a systematic manner, he will make frequent and comprehensive reports to his client without being asked for them. This is a great advantage over having to write continually to lawyers scattered all over the country. The expert forwarder soon becomes familiar with his client's business and methods of doing business and knows how he wants the collections handled.

He can quickly detect cases where the local attorney is endeavoring to protect the debtor, and because of friendship, allowing the latter a longer time for making the payments than he is entitled to take. This condition frequently arises, particularly in the smaller towns where the local lawyer personally knows the debtor who owes money. If detected, this situation can very easily be remedied. Because the receiving attorney knows that the forwarder handles a large volume of business and is likely to have future business in the same town, he gives closer and more aggressive attention to such work than to that of scattered clients who are not likely to have occasion again to employ the receiving attorney. This is the usual rule, despite the fact that the business of the forwarder is handled for only part of the regular fee instead of for the entire amount. A reliable and able forwarder of accounts can be readily found. Unless the collection man understands the forwarding busi-

ness as fully as the forwarder himself does, it will be to his advantage to place in the forwarder's hands all out-of-town bills for collection instead of handling them himself.

11. *Using collection agencies.*—The discussion of the means by which the house may follow up its claims thru a third party has made frequent mention of "attorneys" but it should be noted that this function is often performed with equal or even greater satisfaction and dispatch by "collection agencies."

These agencies are sometimes organized simply as an adjunct of an attorney's office for the special purpose of making collections and sometimes as separate copartnerships or corporations for the same purpose. Thousands of such agencies are organized each year only to go out of business after a brief existence. There are many such agencies, however, with long and honorable records behind them, which are capable of doing excellent work.

Since the ethics of the legal profession prevent attorneys from openly soliciting legal business and certain states by statute prohibit corporations from giving legal advice, many attorneys have organized concerns under various titles as collection agencies to accomplish the same purpose. The National Association of Credit Men has compiled what are said to be the most complete files in existence on agencies generally and its information is available to its members without charge. Collection men all over the country are realizing, because of the mortality among such or-

ganizations and the danger of trusting any but those who give evidence of their stability and reliability, that it is becoming more and more necessary to select them carefully.

12. *How the agency works.*—To show how the better class of collection agency works to bring about a settlement of a claim without resorting to legal action, the following is quoted as part of a typical interview of an agency representative with a debtor against whom he had a claim, who had called at his office to explain why payment was refused:

"But just suppose we did send this account back marked 'uncollectible.' The creditor would forward it to some one else, and continue to do so until it was collected. Do you see those rows of files covering the walls in the next room? Every lawyer and collection agency who receives this account will have similar files, and even if they do return it, your name remains in those files with a notation 'Refuses to pay.' The fact that it has already been sent to six is a good example of their persistence, and before you know it, your name will be in the files of every lawyer and credit agency in the city with an unpaid bill marked up against you.

"Suppose you should go to your bank for a loan. Suppose you should want credit extended you. Do you think it would benefit your cause any, if, on investigation—and they always investigate thoroly—they found that every lawyer and collection firm in the city had an unpaid bill against you in their files?

"Another thing," showing the debtor a daily court record, "this paper is the official court record and legal medium of the County. It is taken and read carefully by every bank, attorney and credit manager in the city. Here you will note

in a conspicuous location a column for suits brought on unpaid bills. Every credit man in the city files these papers and when credit is requested, the first thing he does is to investigate whether the applicant has ever been sued.

"Can you afford to make such a name for yourself? Can you afford to have your name printed here? Frankly, now, can you afford not to pay this bill?

"Does the fact that five attorneys have returned this, justify you in refusing to pay what is justly due on a legal contract which my clients are ready and willing to carry out to the best of their ability?

"Here is a blank check, and a pen.

"If you value your good name, your self-respect, and your credit standing, fill it out."

He picked up the pen automatically and wrote a check in full of account.

13. *Cooperating with the attorney or agency.*— When a claim is placed in the hands of an attorney or agency a full and accurate statement of the facts in the case should be given. The collection man knows the circumstances of the transaction with the debtor; very likely he knows something of his past history. He should tell the collector whether the debtor procured goods thru fraud, whether there is reason to believe that he never intended to pay the bill, whether he ever sent or showed a written statement of assets and liabilities which was false. All these facts, which are seldom precisely stated to the collector, may be of importance. If the debtor has been

guilty of any such practices the creditor generally can cause his arrest, if he is unable to pay a judgment for the claim. Many a debtor who is supposed to be absolutely "no good" will find a way to pay every cent when he is informed that otherwise he will have to begin boarding with the sheriff.

After the creditor states fully all the information he may have in regard to a debtor, he should tell the collector what he wants him to find out. He should find out, for example, whether any judgments or attachments have been filed against the debtor within four months, since it may be that he will have to move quickly to put his man into bankruptcy before the four months elapse. After four months the judgments and attachments cannot be upset in this way and creditors of a debtor, especially if they happen to be relatives or friends, often get a preference. On the other hand, if it appears that there are no judgments or attachments, the debtor will often pay the claim, even if he is in difficulties, rather than have a bees' nest of creditors stirred up by the filing of an attachment of judgment. The collector should next see if the debtor has made any personal property mortgages and if they are properly filed. In nearly all states such mortgages must be filed in the town or city where the debtor resides, and in many states such mortgages must be refiled every year or so in order to be valid as against other creditors.

REVIEW

In what form are black lists permissible? Why must they be used with caution?

Explain the operations of a house collecting agency and the arguments for and against it.

Describe the bad check laws, and their utility in collection procedure.

Explain considerations in selecting a collection attorney in the city where the house is located.

How are attorneys at distant points chosen?

Describe the functions of a forwarder.

Is it desirable to bring suit for the collection of debts?

CHAPTER XVI

CREDIT PROTECTION

1. *Methods of securing protection.*—In a general way, the purpose of all credit management is to afford protection against losses from misplaced credits. The entire system of credit information which has been described is built up in order to enable the credit man to dispense credit judiciously. The wisest of men make mistakes and the question now arises as to the means which may exist for protecting the house after the credit has been granted. Three distinct types of credit protection are available, namely, contract, co-operation and law.

Under the first heading must be considered the various phases of credit insurance whereby in consideration of a premium paid to an insurance company, the loss when it occurs is borne by the latter and not by the creditor. In the second group belong those phases of cooperative effort which are directed to the securing of payments for accounts. Other phases of cooperation have been previously considered. In the third group belong various legal measures whose purpose is to place the owner in possession of his goods when it becomes evident that they have fallen into the hands of persons who are either unable or unwilling to pay for them.

2. *Credit insurance.*—Considering the peculiar nature of credit, it is not surprising that the principle of insurance should have been applied to such transactions. The credit indemnity companies claim to supplement the commercial agencies in two respects: (1) by providing against incalculable losses thru the application of the theory of averages to the field of credit extension; (2) by aiding the credit grantor with such information as comes from the close investigation of the creditor's own business, made necessary by the requirements of the insurance company,

The insurance company makes an investigation of the wholesaler's books in order to ascertain the average credit loss for the past five years. This first or "average" loss must in every case be borne by the insured. The indemnity company regards this loss as within the realms of certainty, and insists that inasmuch as the province of insurance is to deal with uncertainties, the initial or average loss cannot properly be a subject of insurance. Only such losses as are in excess of the initial loss are insurable. Under the terms of the insurance bond, the wholesaler is required to sell only to those retailers whose commercial rating is above a certain grade, the premiums charged being governed largely by the grade of rating allowed. The amount of credit that can be granted to any one customer is made to depend, under the regulations imposed by the credit insurance company, upon the terms of the policy and upon the customer's commercial rating.

For the purpose of illustration, let us assume that a certain wholesale firm has gross sales of $100,000 a year, and that the average annual loss, based upon figures covering a period of five years, is $1,000, or 1 per cent. The amount of insurance allowed to this firm may be represented by a bond for, say, $2,500 on which there is an annual premium of $125, or five per cent of the amount of the bond. In accordance with the terms of the policy, all losses up to and including $1,000 must in this case be borne by the wholesale firm. This amount is the "initial" loss. Only on subsequent losses—that is, losses between $1,000 and $2,500—will the insurance be operative.

Losses sustained as a result of the failure of "rated" customers—those having a capital and credit rating of a certain grade—are covered by the full amounts, or perhaps by an agreed percentage thereof; while losses of the "off-rated"—those with poor rating or with none—are never covered for more than a part of the loss.

The credit insurance company invariably investigates the character of the commercial house to be insured. It considers the line of business in which the applicant is engaged, the class of customers with whom he deals, and finally the business policy pursued by the applicant himself. The basis for determining the amount of the initial loss, the percentage and fixed limit of indemnification and the premium per year, are disclosed by the insured's own books, which tell what class of customers he has, as well as the

volume of business, the size of the accounts carried, the terms of sale, the amount of collections and the general credit policy of the house.

3. *Arguments in favor of credit insurance.*—According to the credit insurance companies, such insurance:

> protects you from losses occasioned by your errors in judgment in extending credit; from losses occasioned thru erroneous mercantile credit ratings furnished you; from your inability to collect what is rightfully yours because of the insolvency of your debtor, due to floods, crop losses, wars, strikes, fires, and other unexpected and uncontrollable causes.

It is further claimed that credit insurance gives the business man control of his costs. Since he knows in advance what costs are due to bad debts, he can enter his insurance premium upon his books at once instead of waiting until the end of the year. By adding this amount to his other fixed expenses, the exact cost of doing business is easily ascertained. Accordingly, he can compute his profits with certainty. His mind is thus free to apply itself more fully and profitably to the productive part of his business. It is possible to increase sales to the maximum amount and still keep losses at a minimum.

As by the terms of the indemnity bond he is offered protection only within certain restrictions, the credit man learns to watch his customers' accounts more carefully in order that he may obtain lower in-

surance rates the following year as the result of a reduction of his average loss.

It is also claimed that credit insurance tends to promote trade and to prevent panics, since the confidence which it begets makes business men more aggressive and enterprising.

4. *Arguments against credit insurance.*—Business men, however, are not all convinced that the claims made for credit insurance as a "paying" innovation in the conduct of business have been realized. Many business men ask whether it is not a fact that the normal loss—which they in every instance must bear, and which represents the aggregate of all credit losses during a number of consecutive years—includes the very risks that the indemnity company offers to insure.

This argument appears to be well founded, especially when we consider that in the nature of things every credit loss is abnormal. The normal course of every credit transaction is its ultimate liquidation by payment at the expiration of the credit period. But since experience proves that in practically every wholesale business some accounts remain unpaid, and that the amount of losses thus incurred are about the same from year to year and represent a certain percentage of gross sales, the wholesaler is in the habit of offsetting this loss by adding his loss percentage to the selling price of his goods. He protects himself in this way against diminished profits caused by bad debts. But having done this, he is likely to regard

any premium which he is asked to pay for "losses" above this amount, as an added expense for which he receives no adequate return. He knows that even tho in some one year his losses should slightly exceed this normal amount, it is extremely improbable that the average losses of the next five or ten years would be higher.

Nor does it appear, as some seem to think, that credit insurance permits less vigilance on the part of the credit man, since by the terms of such insurance he is compelled to watch his accounts even more closely than before, lest by a violation of the insurance company's stipulation he should forfeit his right to indemnity when a loss occurs.

That credit insurance, even if it were more commonly used than at present, should be able to exert any appreciable influence upon the causes that produce a financial panic, is, to say the least, doubtful. Such panics, with their attendant disorders and financial distress, are commonly brought on by an over-extension of credit. The remedy lies therefore plainly in the direction of conservative credit management and is not found elsewhere.

5. *Adjustment bureaus.*—As a natural result of the efforts or cooperation thru the National Credit Men's Association, a number of activities have been developed which have rendered very direct benefit to credit grantors by way of providing credit protection. Among them a considerable share of the association's activities has been given in late years to the organiza-

tion and operation of adjustment bureaus among the local associations, the object being to use the forces of the Association in the interest of a conservation of the assets of insolvent merchants and the prevention of bankruptcy proceedings. That for lack of proper and friendly supervision many a business failure has been precipitated is beyond dispute, just as for the same reason many a bankrupt's estate has been so loaded with settlement expenses that but little of it remained for distribution among the creditors.

Inexperience or some untoward circumstances may easily bring about an involved condition in the affairs of a dealer whose motives and intentions are of the very best. If he is thrown into bankruptcy thru the inconsiderate course of some creditor, his business life is usually wiped out along with his business. The loss to creditors is therefore not only that which they sustain directly thru a partial loss of their accounts, but also that which comes indirectly thru the loss of his future business. With the exercise of proper care, not only might the accounts in such a case ultimately be paid in full, but the delinquent himself would be able to continue in business and remain a customer of the creditor houses.

The local bureau of the Association will, upon request, investigate the affairs of any debtor reported to be insolvent or financially embarrassed, and will thereafter take such steps for the protection of creditors as may be required by the circumstances. The bureau is prepared to act as assignee, trustee, or

receiver in bankruptcy whenever called upon to do so.

It should be remembered, of course, that similar services are rendered by many trade associations and by credit bureaus other than those of the National Association of Credit Men. The trend of modern credit management is noticeably toward protection of the debtor's assets, and preservation of his business existence. The fact that adjustment bureaus, conducted by local branches of the associations, are found in more than sixty cities, is proof of the popularity of this service among members of the Association and others.

6. *Means of recovery.*—Since the object of sales is profit, the seller is necessarily anxious to have each sale go thru in order that the profit may be realized. There are times, however, when it is prudent to abandon hopes of profits and to take account of the means available for preventing losses. In other words there are times when the remedies have to do with salvaging the goods after a contract of sale has been made, viz., foreclosure of the unpaid seller's lien, *stoppage in transitu,* and recovery of goods transferred under a fraudulent contract.

7. *Unpaid seller's lien.*—An unpaid seller who actually has possession of the goods may in any one of the three following cases, retain possession of them till he is offered payment: (1) when no credit was anticipated by the contract; (2) when the term of credit has expired; (3) when the buyer becomes insolvent.

8. *Stoppage in transitu.*—Even if the seller no longer has possession, he may protect himself against an insolvent purchaser by resorting to the remedy known in law as *stoppage in transitu.* But to avail himself of this relief he will have to act quickly. If he can get notice to whoever is in charge of the goods while they are in transit, i.e., before they get into the possession of the buyer, that person will be bound to return the goods to the seller, who will then have the same rights in them as if he had never parted with their possession.

Nice questions frequently arise as to whether the goods are still *in transitu.* Goods are still in transit while they are in the hands of the carrier. The right of *stoppage in transitu* is lost in any one of the following cases, because the goods are no longer technically in transit: if the buyer or his agent gets possession before the goods arrive at their destination; or if, having arrived, the goods are confessedly held by the carrier as the bailee of the buyer; or, if having arrived, they are wrongfully withheld from the buyer.

When the carrier is properly notified, he must redeliver the goods to the seller, upon whom falls the burden of expense. Moreover, if a negotiable document of title, i.e., a bill of lading, has been issued by the carrier, the goods should be withheld by the carrier till this instrument has been surrendered for cancelation.

The right of stoppage is open to the seller only after the buyer has become insolvent. The Uniform

Sales Act which has been adopted in a number of states reads, in part, as follows:

> A person is insolvent within the meaning of this Act who either has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of bankruptcy or not, and whether he is insolvent within the meaning of the federal bankruptcy law or not.

There is no Uniform Sales Act in Canada, but the general rule may be laid down that if, after shipping the goods, the seller finds that the purchaser has become insolvent or is on the eve of insolvency, he may stop the goods in transit. A person who has ceased to pay his debts in the ordinary course or who cannot pay his debts as they become due, would be deemed to be on the eve of insolvency.

9. *Reselling the goods.*—Suppose the seller actually has possession of the goods now, either because he has exercised his primary lien, or because he has recovered them thru his right of stoppage. What may he do with them? He may resell them. If they are perishable, he does this immediately; if they are not perishable, he waits a reasonable time for the buyer to pay the price. If the goods are not perishable, the seller will act wisely if he notifies the buyer of his intention to resell the goods. This notice is not absolutely indispensable, but it establishes the seller's good faith in the transaction. If the seller makes an extra profit in the resale, he is entitled to retain it, but

if he suffers any loss, he may hold the original buyer in damages.

10. *Recovery on the ground of fraud.*—If neither of the two remedies just described is available, one more is left. The seller may be able to have the entire transaction set aside as fraudulent. It must be remembered, however, that lawyers realize that it is always difficult to prove fraud. The mere fact that the buyer is insolvent is not proof that he has practised fraud. But if a seller has relied on a fraudulent financial statement, he may be able to prove the case against the buyer. Then, too, it must be remembered that even tho the buyer is guilty of fraud, he actually obtains title, and that this may be transferred to an innocent purchaser. In discriminating between the latter and the original seller, the courts favor the innocent purchaser, since he could not be justly blamed for his part in the fraudulent transaction.

11. *Steps in litigation.*—Let us suppose that the creditor has no opportunity to recover the goods, or that if he has, he does not think it wise to make use of the opportunity. What procedure is necessary to obtain the redress provided by law? Since we are interested here only in the purely legal phases of collection, we shall say nothing about the work of the attorney as a collector. That phase of the subject has been treated elsewhere.

Generally the law does not give the creditor full recognition as creditor till his status has been estab-

lished in a court of law. In order to get the debtor into court, it is necessary to serve him with a summons. Then, that the time of the court may not be wasted, the parties state, in documents known as pleadings, what they expect to prove. At the proper time a trial is held; the evidence is submitted to sustain the allegations made in the pleadings; and a judgment is issued either for the plaintiff or for the defendant. If the latter wins the case, the complaint is dismissed, and a money judgment is entered against the plaintiff for costs. Frequently the debtor has no defense, and merely defaults. If this is the outcome, a judgment is entered against him without a trial of the case. It must be understood that this summary is only the barest outline of judicial proceedings in an ordinary action to collect a debt. The details are technical in a high degree, and are therefore usually left entirely in the lawyer's hands.

12. *Importance of evidence.*—While the court will consider any statement that savors of the truth, it places strong emphasis upon the importance of evidence. A person may be absolutely certain that he has a meritorious case, yet if he cannot bring forward evidence, his suit will be dismissed. The motto of Cromwell and his soldiers, "Trust in God, and keep your powder dry," expressed no less faith because of its implication that man must do his part. And similarly, we show no lack of confidence in those who administer justice, tho we say, "Trust in the courts, and be sure to give them a good case."

Lawyers must depend on their clients for the facts. While some concerns are very successful in their collection cases, other houses are not nearly so successful. Cases are lost because delivery slips have been mislaid, or because signatures or order forms cannot be proven. While on the one hand, it is unwise to arouse a customer's suspicions by checking his account too critically, certainly on the other hand, it is merely ordinary business prudence to remember that at any time a debt may have to be established in a law court by sufficient competent evidence, and to conduct one's affairs accordingly.

13. *Enforcing the judgment.*—A judgment is no better than the judgment debtor. One cannot squeeze water out of a stone, nor can one get money out of a pauper. There are some debtors, however, who can pay their judgment, but will not. To gain access to the property of unwilling debtors is not the least important part of the collection process. After the judgment is docketed, an execution is delivered to the sheriff or to some other executive officer of the county or city, who is thereupon directed to make a levy on the goods of the debtor. If the levy is made, in due course the goods are sold at public auction and the judgment is satisfied out of the proceeds. If no goods are found, the execution is "returned unsatisfied." The completion of this process paves the way for the other remedies provided by law.

14. *Exemptions.*—One purpose of the law is to prevent people from being reduced to poverty. In

such a condition they would be a charge to the community. Hence laws have been passed which exempt certain property from seizure to satisfy debts. Usually such exemption applies to a small homestead, necessary clothing and home utensils, certain domestic animals and a low income.[1]

15. *Supplementary proceedings.*—When a judgment is returned wholly or partly unsatisfied, the creditor has the right to discover concealed property. Generally it is useless for him to begin these proceedings unless he has some grounds for believing that property has been sequestered. But if this has been done, a clever examiner can usually prove the fraudulent concealment and can ferret out the property by means of a vigorous examination.

16. *Setting aside fraudulent conveyances.*—It may happen that the debtor has actually parted with title to his property, altho the transfer was made without adequate consideration and was effected for the purpose of preventing creditors from collecting their debts. The facts in such a situation are frequently brought out in supplementary proceedings, and are then made the basis for a so-called judgment creditor's action, the purpose of which is to set aside the illegal transfer. If this is accomplished, the goods can be

[1] Digests of exemption laws may be obtained and should be at hand for instant reference. A good collection of such laws, as well as of other statutes enacted by the legislatures of the various states, is that contained in Martindale's "American Law Directory" (New York). That volume presents a large amount of legal information that is of interest in all credit matters.

taken in satisfaction of the judgment and of the costs of the various legal proceedings.

The burden of proving fraud is on the creditor, and difficulties that tend to prevent proof always present themselves. The vigilant creditor will anticipate these difficulties by a little detective work in season, and the credit man who "has a nose" for fraud and who can present to his lawyer concrete evidences of underhand work on the part of the debtor, is a valuable factor in the recovery.

17. *Bulk Sales Law.*—In cases of litigation the burden ordinarily rests on the creditor to prove that the debtor is guilty of making a fraudulent transfer, but according to modern statutes conditions are reversed if the debtor transfers his goods in bulk—i.e., not in the ordinary course of trade.

18. *Receivers.*—When there is question about the ownership of property, and there is danger that some person who may have a rightful claim upon it will suffer if the present owner continues in possession, a court will appoint a receiver to take charge of the property till all claims can be determined judicially. Suppose, for example, that the debtor has title to an apartment house that is heavily mortgaged. The debtor may be collecting his rents and squandering them, instead of paying the taxes and the mortgage interest, thus courting foreclosure instead of protecting his equity for the benefit of his creditors. These facts would move an equity court to take over the property thru the instrumentality of a receiver. In

the Province of Quebec a sequestrator would be appointed by the court upon petition.

19. *Garnishment.*—The term garnishment applies to the legal process whereby property which belongs to a debtor, but which is in the hands of a third party, may be reached to satisfy the debtor's debts. By means of this process all forms of property may be reached, including even a part of the debtor's salary. Garnishment proceedings are generally governed by the statutes of the several states or provinces which must be consulted in order to find out how and to what extent each jurisdiction permits the use of this form of securing payment.

20. *Attachment.*—It has already been stated that the procuring of a judgment is merely one of the steps in the legal collection of a debt. Even when a suit is diligently prosecuted, from the serving of a summons to the entering of a judgment, so much time may elapse that a fraudulent debtor may have ample opportunity to make himself "judgment-proof" by moving his property to another jurisdiction or by giving it away. The law provides the creditor with a so-called provisional remedy against this practice. The creditor may begin his action by attaching the debtor's property. In this case affidavits are submitted to the court which, on being satisfied that there is ground for applying the remedy, will order that the property of the debtor be seized and held before judgment. If after that the creditor gets a judgment, he is immediately in a position to satisfy it. If, however, he

fails to get a judgment, the property is released and the plaintiff is bound to pay all the costs and damages. To guarantee payment he is required to put up a bond when the attachment proceedings are instituted. Since the costs and damages are relatively heavy, attachment proceedings must be very carefully begun and as carefully prosecuted. Any of the following conditions generally constitute grounds for an attachment: (1) if the defendant is a foreign corporation or a non-resident individual; (2) if the defendant has evaded the service of the summons; (3) if he has concealed himself; (4) if he has disposed of his property with intent to defraud creditors; (5) if he has made a false statement in writing regarding his financial responsibility.

Attachment is generally regarded as an extreme remedy—one not to be resorted to without first securing competent legal advice. Sometimes instead of actually seizing the property it may be better to obtain an injunction forbidding the debtor to dispose of it. If this method is adopted and the plaintiff subsequently fails to get a judgment, the damages he would have to pay the defendant would not be so heavy as if he had seized the defendant's property and then failed to win the case.

21. *Imprisonment for debt.*—Altho imprisonment as a punishment for debt is today seldom resorted to, the debtor may, in some cases involving moral turpitude, be imprisoned if his judgment debt is not paid. Generally the summons or pleadings must contain

some notice that the plaintiff intends to have the debtor imprisoned if the latter loses the case and still refuses to pay what he owes. This provision gives the debtor opportunity to defend an action which otherwise he might permit to go by default. Such procedure is generally allowed when the debtor has been guilty of fraud in incurring the liability, or has fraudulently disposed of his property. Since this remedy, like garnishment, is statutory, the method of using it and the extent to which it may be used varies in different states and provinces.

22. *The criminal law as a remedy.*—It is a general principle of law that creditors may not use the criminal courts as collection agencies. And this, notwithstanding the fact that there have been many instances in which a fraudulent debtor has been as much a menace to society as a common thief. Indeed the individual can protect himself against the thief by means of lock and key, but the fraudulent debtor is a worse cheat. The law is in the latter case the sole defense. Recognizing these facts, state legislatures have recently enacted laws making it a crime for any person to obtain credit by means of a false financial statement. In Canada, under the Criminal Code, a Dominion Statute, it is a crime to induce a person, by a false pretense or representation made with fraudulent intent, to act upon such representation, as, for instance, to part with goods. While the punishment of the delinquent may in no wise help the defrauded creditor, the demands made by society upon the credit

man should be sufficiently strong to urge him to aid in carrying out the provisions of the criminal law.

23. *Shall we go to law?*—An eminent English lawyer, Mr. Maryatt, King's counsel, once expressed the following opinion in regard to lawsuits:

> If any man were to claim the coat upon my back, and threaten my refusal with a law suit, he should certainly have it; lest in defending my coat, I should find that I was deprived of my waistcoat also.

Bouvier, the eminent legal lexicographer, defines a good lawyer as one who, among other things, "is disposed to avoid litigation." Certainly litigation is frequently fruitless and is always expensive. A good credit man will seek to avoid being caught in bankruptcies and will as far as possible keep his concern from the need for litigation by guarding well against improper credit extensions. But if it appears necessary to resort to the courts, he will first ask, "If I do get a judgment can I collect it?" Then he will remember that to get his judgment and to collect it he will need "a good cause, a good purse, a good counsel, a good judge, a good jury and good luck."

REVIEW

Examine the claims made for credit insurance, and formulate answers to meet these claims if they appear to you as not well sustained.

Why would you commend the work of the adjustment bureaus?

When may a shipper exercise the right of stoppage *in transitu,* and when is he debarred from exercising that right?

How are goods recovered when there has been misrepresentation or fraud?

CHAPTER XVII

BANKRUPTCY

1. *Meaning of bankruptcy.*—In ancient Rome, when a money-changer became insolvent, he was put out of business by his associates who broke the bench upon which he kept his stacks of coin. Some people believe that this rupture of the bench or bank is the explanation of the derivation of the word bankrupt. Certainly the process indicates very nearly what happens today. A man is insolvent; then the condition is proclaimed, not, to be sure, by the breaking of a bench, but by the signing of a decree of bankruptcy by a competent court.

Bankruptcy, then, may be defined as a process pursuant to some statute whereby an insolvent is declared a bankrupt, his property taken and equitably distributed among his creditors, after which he is discharged from further liability. Under the older bankruptcy acts of Anglo-Saxon jurisprudence, the object was to get the insolvent's property, but the later legislation recognizes the importance of the discharge from liability as a means of renewing the economic vitality and effectiveness of an unfortunate debtor.

2. *Meaning of insolvency.*—The law recognizes two definitions of insolvency. When a man has plenty

of unliquid assets—a person is said to be land-poor for example—and cannot pay his debts as they mature in the ordinary course of business, he is said to be insolvent. He may have plenty of wealth; what he needs is time to get it into the proper form to use it for discharging his obligations. If his creditors try to force the process of conversion by getting judgments, seizing parts of the property and offering them at forced sale, the value of the property, disrupted and deprived of the opportunities of fair bargaining, may shrink to an amount actually less than the aggregate of the indebtedness. The appointment of a receiver will prevent this helter-skelter seizure of property, and time may be obtained to make a reasonable sale. Frequently, when the true condition of the debtor is understood some arrangement will be made to give him a reasonable extension. Receiverships are thus a very important aid in the work of the credit man.

Another definition of insolvency contemplates a debtor whose assets are, at a fair valuation, less than his liabilities. It is this definition that is recognized by the bankruptcy law, which provides that the prerequisite of bankruptcy must be insolvency.

3. *Bankruptcy and insolvency laws.*—At one time in England the difference between bankruptcy and insolvency was quite different from what is indicated in the preceding section. In those days only traders became bankrupts. Gentlemen of leisure became insolvents, and since trading was regarded as unrefined,

and "tradesman" was a word which when applied to a person of gentle birth lowered his social rank, to call a nobleman a bankrupt was sufficient cause for a slander suit.

The distinction between insolvency laws and bankruptcy laws today does not rest on these considerations. Technically there is no difference between these laws, but by general custom the words "bankruptcy law" in this country are reserved for the federal act and the words "insolvency laws" are generally applied to the state acts.

4. *State and Federal laws.*—Congress is given power to pass uniform bankruptcy laws for all states. If Congress does not exercise that power the states may have their own insolvency acts. Thus we find on the statute books of almost every state a bankruptcy law that is inoperative because the Federal bankruptcy act has superseded it. But the operation of the state laws is simply held in suspense, for if Congress should repeal the Federal act, as has been done on several occasions, the state acts would immediately spring into force.

The present Bankruptcy Act dates from 1898, amendments having been made in 1903 and 1910.

5. *Two kinds of bankruptcy.*—Under this act, the proceedings which result in the decree of bankruptcy are begun by filing a petition. This petition is a written document alleging the essential facts necessary to warrant the court in adjudicating the insolvent person a bankrupt under the terms of the statute.

If the petition is signed by the debtor himself, and proceedings are thus begun by him, the bankruptcy is said to be voluntary. In such a case the main object proposed is the final discharge of the debtor from liability. If, on the other hand, the petition is signed by creditors, the proceedings are called involuntary, and the main object is to get the bankrupt's assets and to apply them ratably to the payment of his debts. Thereafter the bankrupt may apply for his discharge just as he would in voluntary bankruptcy.

6. *Contents of the petition.*—Petitions may be filed against any person who might seek voluntary bankruptcy, with the exception of farmers or tillers of soil and wage-earners earning less than $1500 a year.

Besides showing that the alleged bankrupt is a person capable of being declared a bankrupt, and is insolvent, the petition must show that the debtor owes at least $1000 in the aggregate. If the proceedings are involuntary the petition will have to be signed by three creditors whose aggregate claims amount to at least $500, or by one creditor with a $500 claim if the total number of creditors, excluding certain near relations, are less than twelve. Moreover, it is necessary to allege in involuntary proceedings that the debtor has committed a so-called act of bankruptcy.

7. *Acts of bankruptcy.*—The fact that a person happens to be insolvent is not sufficient reason for setting the machinery of the bankruptcy courts in motion. These courts exist for the purpose of protect-

ing creditors and helping insolvent debtors to gain a new lease on life. If the latter object alone is to be attained let the debtor begin his voluntary proceedings. But until the creditors' rights are jeopardized the courts need not interfere on the ground of protecting the creditors' claims.

The Bankruptcy Act, therefore, enumerates five acts which, when coupled with insolvency, are grounds for believing that the rights of the creditors as a class are in danger. When the creditors can prove that one of these acts has occurred, the insolvent debtor will be declared a bankrupt.

8. *The five acts of bankruptcy.*—The acts of bankruptcy enumerated by the statute are as follows:

(1) Transferring or concealing property with the intent to defraud or hinder creditors.

(2) Granting preferences. If a debtor pays an antecedent debt due to one creditor he thereby diminishes his estate applicable to the payment of his other debts.

(3) Preferences permitted by legal proceedings. When a creditor gets a judgment, he is entitled to seizure of such a part of the debtor's estate as will satisfy the judgment. If the execution sale actually takes place it will have the same disastrous effect on other creditors as a voluntary payment. Hence unless the proceedings are vacated within five days of the date advertised for the sale, the debtor will be deemed to have committed an act of bankruptcy.

(4) An assignment for the benefit of creditors or

the appointment of a receiver is ground for an application to the bankruptcy courts. This explains, no doubt, why assignments generally are not made. They simply invite bankruptcy proceedings; why not, therefore, begin the proceedings at once?

(5) Written admission of insolvency and willingness to be declared a bankrupt is the fifth ground. Before 1910, it was frequently used by insolvent corporations, because prior to an amendment of that year corporations could not become voluntary bankrupts.

Any one of these acts, committed while the debtor is insolvent, and within four months of the filing of the petition, is sufficient to move the court to sign the decree.

9. *Provisional remedies pending adjudication.*— Suppose an involuntary petition has been filed. The facts stated in it may be denied by the alleged bankrupt. He has at least five days in which to answer. That time will give a dishonest debtor ample opportunity to lay up stores against the time when he will emerge from the period of bankruptcy by an unmerited discharge. But the law is adequate to meet the situation, and a wide-awake credit man will be diligent to use every resource which the law affords.

In the first place an order may be obtained for the immediate seizure of the debtor's goods, or he may be enjoined from disposing of them. If he disobeys the injunction, he may be jailed for contempt of court. If the insolvent tries to evade bankruptcy or examina-

tion of his assets by leaving the jurisdiction of the court, application may be made for his immediate arrest. Moreover a creditor need not wait till a debtor has been declared a bankrupt but may begin separate actions to have illegal and fraudulent transfers of property set aside. These actions will be continued afterward, virtually as a part of the bankruptcy proceedings.

The usual remedy sought by creditors is the appointment of a receiver. This officer can then proceed to reduce all property to possession and can begin to straighten things out for the trustee.

10. *Trial and reference of proceedings to referee.* —After the alleged bankrupt is given a reasonable opportunity to deny that he should be declared a bankrupt, either the petition is dismissed because it has not been sustained by proof, or the decree is signed—either on account of the bankrupt's failure to answer or because the facts alleged in the petition are found to be sufficient and true. The usual course is the signing of a decree upon default.

The proceedings are then referred to a referee who really has charge of the entire matter from this time on with the exception of the confirmation of any proposed composition with creditors and the final discharge of the bankrupt. These proceedings must again come before the court. Referees are appointed by the federal court for a term of two years. They have such intimate relations with all the proceedings

that the law provides for at least one referee in each county.

11. *Meetings of creditors.*—The referee attends all examinations of the bankrupt, declares dividends, requires the filing of schedules and notifies creditors. His first act is usually to call the creditors' first meeting at which a trustee is elected by the creditors and the amount of the trustees' bond is fixed. Creditors are often of great assistance to receivers and trustees in giving suggestions, and it is important that they attend meetings. But they do not run the estate. The court always retains jurisdiction and in effect merely seeks the views of the creditors in order to come to a wise decision. Notices of meetings and other proceedings should be carefully observed and filed away for future reference.

12. *Trustees in bankruptcy.*—As soon as the creditors can get together they elect a trustee who takes the custody of the property from the bankrupt or from the receiver. The election of the trustee is usually made on the basis of two votes—one on the per-creditor basis and the other on the per-dollar-of-claims basis. If both votes result in the selection of the same candidate his election is usually approved by the referee. If there is a conflict in the results of the two votes the referee appoints a trustee—usually the person who received the largest number of per-creditor votes.

Probably in most cases the selection of the trus-

tee comes about in the following way: After the petition in bankruptcy has been filed, the attorneys for the petitioning creditors ask for a receiver. When the receiver is appointed, application for counsel for the receiver is made and the same attorneys are retained. Subsequently the receiver is likely to be elected trustee of the estate since he has the claim of being familiar with its affairs. Then, upon application for the appointment of counsel for the trustees, the same lawyers are again retained. In this way the matter is practically always under the guidance of the lawyers of the petitioning creditors.

The trustee takes title to the bankrupt's property and does all things necessary, even to the bringing and defending of actions, to conserve the estate for the benefit of the creditors.

13. *Duties of bankrupt.*—The bankrupt is required to help in the administration of his estate, and he is a wise person who undertakes this task willingly and earnestly. The bankrupt must attend such meetings and submit to such examinations as may be deemed necessary. Indeed, the receiver and the trustee in seeking to discover all the bankrupt's property in order to reduce it to possession may examine not only the bankrupt, but his friends, family and associates. When claims are made against the estate, the trustee usually consults with the bankrupt to see if the claims are valid. Moreover, the bankrupt is required to file schedules of his assets and debts.

14. *Schedules.*—As was pointed out before, the

bankruptcy proceedings include besides the discharging of the bankrupt from his debts the gathering up of the assets and the applying of the assets to the payment of liabilities. The schedules in bankruptcy are, therefore, an index to the entire proceedings. They list all the assets and arrange the liabilities in the order in which they will have to be paid.

In voluntary proceedings the schedules must be all ready to file with the petition. In involuntary proceedings they are filed within ten days after the decree has been signed. In either case they are filed on standard forms which can be procured at any law stationers.[1]

15. *Valid, provable and allowable claims.*—The difference in the words "valid," "provable" and "allowable" as applied to claims against a bankrupt's estate is important and should be understood at the outset. First, let it be known that allowable claims must be provable and must be proved before the question of allowance arises and that all provable claims must be valid. Therefore, there may be valid claims that are not provable and provable claims that are not allowable.

16. *Valid claims.*—A claim is valid which outside

[1] The reader who desires to complete his information on this subject will do well to apply at the office of the clerk of a federal district court for all the papers in any bankruptcy proceeding that strikes him as being interesting. For this purpose he should first consult the bound register of proceedings and select a contested involuntary case in which a receiver has been appointed, The papers beginning with the petition and ending with the discharge can then be examined carefully and will serve to make much that is contained in this chapter concrete and to impress it on the memory.

of bankruptcy proceedings is not subject to any defense that might be raised by the debtor. A valid claim must have foundation in law. Thus, for example, if a father is bankrupt, some person whom his minor son has injured might make a claim against the bankrupt's estate. The claim would not be valid since every infant is responsible for his own wrongs. In this case no question as to the provability of the claim would arise. The claim would be rejected immediately since it is not valid.

17. *Provable claims.*—Before claims may be allowed against the estate, they must be proved. This is done, to use the words of the Bankruptcy Act, by the creditor who files a formal affidavit "setting forth the claim, the consideration therefor, and whether any, and if so what, securities are held therefor and whether any, and if so what, payments have been made thereon, and if the sum claimed is justly owing from the bankrupt to the creditor."

The United States Supreme Court is given power to supplement the bankruptcy law in such ways as it may deem expedient. In some of its general orders it has prescribed the form in which proof of claims shall be made. The creditor will do well to follow this form by procuring an official blank from a law stationer. When the claim is on a promissory note, the original note should be attached to the proof of claim.

Generally, tort claims such as claims for damages from negligence, slander or trespass, and contingent

claims are not provable. Rent due or accrued before the petition is filed is provable; rent due after the petition is filed may not be used as a claim against the estate unless the trustee elects to treat the lease as an asset of the estate. Claims actually arising before filing the petition, tho payable thereafter, are provable. Claims arising after the petition is filed are not provable and remain as a charge against the bankrupt after his discharge in bankruptcy.

As we shall see, bankrupts are not discharged from the burden of judgments obtained for fraud, deceit or the like, but the claims arising therefrom are provable. Unliquidated contractual debts are provable but must be liquidated before being allowed. Thus a doctor may prove his claim for services, but the amount due must be settled before the claim can be allowed.

Provable claims must be proved within one year from adjudication. The credit man as a matter of good business should proceed immediately to file his claim as soon as he learns that the decree has been filed.

18. *Allowable claims.*—Usually before the first meeting of creditors, many proofs of claims will have been filed. If they are not in proper form or if they are in the class of unprovable claims, they will be rejected. If, however, they are provable and have been proved, the next question to decide is whether they shall be allowed. Generally all provable claims are allowable. The two important exceptions are first,

secured claims which are allowable only to the extent of the difference between the amount of the claim and the value of the bankrupt's property securing the claim, and second, claims with voidable preferences which will not be allowed till the preferences are surrendered.

19. *Voidable preferences.*—A preference is defined by the Bankruptcy Act as follows:

> A person shall be deemed to have given a preference if, being insolvent, he has, within four months before the filing of the petition or after the filing of the petition and before the adjudication, procured or suffered a judgment to be entered against himself in favor of any person, or made a transfer of any of his property, and the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class. Where the preference consists in a transfer, such period of four months shall not expire until four months after the date of the recording or registering of the transfer, if by law such recording or registering is required.

We saw that a preference, within this definition, constituted an act of bankruptcy (Section 8 of this chapter). Beyond what is necessary to prove that a preference has been given constituting an act of bankruptcy it must be shown that the creditor knew or had reason to know that he was being preferred. If this can be shown, then the preference, if it conforms to all the other requirements of the above definition, will be voidable, and as we saw, the creditor will have to give up the preference if he wants to get

any further benefits from the estate by having his claims allowed.

20. *Priority of debts in distribution of bankrupt's estate.*—In dividing the bankrupt's assets among creditors certain priorities are established by the law, the order being as follows:

1. Taxes due United States government.
2. Other taxes.
3. Cost of preserving and administering the bankrupt's estate.
4. Fees paid to the court clerk by creditors and one fee for attorney of bankrupt or petitioning creditors.
5. Wages, not exceeding $300, earned during three months prior to the filing of the petition.
6. Claims secured by valid unavoidable liens.
7. Debts given priority by United States or State laws.

The claims in each class will have to be paid in full before claims in any subsequent class can receive any payment whatever. The last class to be paid is the general unsecured claims.

21. *Dividends in bankruptcy.*—As was stated in the previous section, general creditors are entitled to no dividends whatever until the priority claims have been taken care of. If, after these have been paid, there is a surplus equal in amount to five per cent of the general claims, a dividend must be paid on them within 30 days of the adjudication of bankruptcy; and thereafter dividends must be paid when-

ever the realized surplus equals 10 per cent of the general claims. The law also provides that the first dividend cannot exceed 50 per cent of the general claims, that the final dividend must not be paid within three months of the adjudication and that the dividends must not be less than two in number.

22. *Composition with creditors.*—Every credit man knows that litigation is expensive. If it becomes evident that the bankrupt is honest and that there is to be little difficulty in ascertaining the amount of his estate, it may be wise to permit him to handle his own affairs and to accept his proposal to pay so many cents on the dollar as a full discharge of his duties. In determining whether a composition shall be accepted or not, due consideration must be given to the honesty and ability of the bankrupt, to the possible value of his estate and to the number and size of the claims that will probably be presented and allowed.

A composition with creditors must always be confirmed by the court. If it has been confirmed, the bankrupt may apply for his discharge. Under the law the court cannot confirm a proposed composition unless the following conditions have been met. (1) the schedules must have been filed; (2) the bankrupt must have been examined; (3) the composition must have been accepted in writing by the majority of the creditors representing more than half the bankrupt's debts; (4) enough money must have been deposited in amount to pay (a) the composition, (b)

the cost of court proceedings, (c) preferred debts in full; (5) the judge must be satisfied that the composition will best serve the interests of all the creditors; (6) it must be established that the bankrupt has not committed fraud; (7) the composition must not be fraudulent; (8) the composition must not be for much less than the real value of the estate. When the application is being made for the confirmation of the composition, any creditor may object at the hearing and raise the objection that any one of the conditions above enumerated is lacking. After hearing all sides, the court can use its own discretion in confirming or rejecting the composition.

23. *Discharge of bankrupt.*—As was indicated above, one of the main purposes of bankruptcy laws is to discharge the bankrupt debtor, thereby giving him a new start in life. Under the present bankruptcy act this discharge may take place any time after one month from adjudication. Application for a discharge must be made within twelve months of the adjudication of bankruptcy, but this time may be extended six months by the court. The bankrupt cannot be discharged from liability for his debts if he is guilty of fraud or has been previously discharged in bankruptcy within six years.

24. *Debts not discharged in bankruptcy.*—The effect of a discharge generally is to cancel all liability on debts incurred before the filing of the petition. A discharge in bankruptcy, however, does not cancel the following debts:

1. Those incurred after the petition has been filed.
2. Taxes.
3. Liabilities for obtaining property under false pretenses.
4. Liabilities for wilful or malicious injury to property or persons.
5. Alimony.
6. Support of wife or child.
7. Debts not scheduled in time for proof and allowance unless it can be shown that the creditor had actual notice of proceedings.
8. Debts arising out of the bankrupt's breach of fiduciary obligations.

Liabilities falling in any one of the classes above enumerated remain a burden on the bankrupt after his discharge and the creditor will be justified in seeking to enforce the obligation by taking any proceedings he might take if the bankruptcy proceedings had never been instituted.

25. *Advantages of Bankruptcy Act.*—The National Credit Men's Association has done an excellent piece of work in keeping the present bankruptcy act on the statute books. This act has frequently been attacked by certain interests that would probably profit by a recurrence to the confusion in which business was steeped when the property of insolvent debtors was subject to administration under state laws. The present Bankruptcy Act insures fair and uniform treatment to all creditors and provides a safe method of reaching an insolvent debtor's property.

26. *Canadian practice.*—There is no national bankruptcy or insolvency law in Canada, and there has not been since 1880. Each province has its own insolvency laws and procedure. In none of the provinces is a debtor discharged by becoming an insolvent. If the dividend from his insolvent estate does not meet the claims of his creditors in full, they have their recourse for any balance so long as their claim is not outlawed. The discharge from further liability is an incident of bankruptcy legislation, and as such could only be enacted by the Dominion parliament. The general effect and purpose of the provincial insolvency laws is to secure a ratable distribution of an insolvent's estate among his creditors.

27. *Procedure.*—A trader who finds himself in difficulty may make a voluntary assignment of his estate for the benefit of his creditors. The assignment may be made to the sheriff of the county, to an official assignee or to a resident of the province approved by a majority of the creditors whose claims amount to $100 or more.

In Quebec alone can a debtor who is in insolvent condition and yet refuses to assign, be forced to do so. He must either pay or be subject to civil arrest, in which case his assets are seized and dealt with for the benefit of creditors.

In the other provinces much the same practical result is secured by proceeding under the provincial Creditors' Relief Act. In the first place, if an insolvent trader refuses to assign, an action may be

brought by one creditor on behalf of himself and all other creditors of the same class, and under his judgment all the assets may be sold and the proceeds ratably distributed among any executive creditors and other creditors who prove and file their claims within the proper delays.

On the other hand, if a judicial assignment is made, then another procedure is followed. In most of the provinces, other than the Province of Quebec, a copy of the assignment with an affidavit of a witness must be registered—generally at the office of the county court clerk, tho in some provinces at the office for registry of deeds. In all the provinces the assignment must be advertised in the *Official Gazette* and in one or more newspapers. This notice calls the creditors to a general meeting and notifies them to prove and file their claims. Claims should be accompanied with such vouchers as the nature of the claims permits. At the general meeting a curator is appointed, and he proceeds to get in all assets, to realize on goods and property, pay privileged claims and pay a dividend to ordinary creditors.

28. *Fraudulent conveyances and transfers.*—Gifts or other gratuitous contracts made when a person is unable to pay his debts in full or knows that he is on the eve of insolvency, are deemed to be made with intent to defraud creditors, and may be set aside. That is the general rule of the English law provinces. In Quebec every conveyance or transfer of either personal or real property with the intent to delay or de-

fraud creditors by any person who knows he is on the eve of insolvency is void against such creditors, providing the other party to the contract knows his intention and acts in collusion with him. So also a large payment of money or a transfer of property by an insolvent to a creditor knowing his insolvency, is deemed to be made with intent to defraud, and such creditor may be compelled to make restitution or pay the value, for the benefit of all creditors concerned. And generally, where a debtor in insolvent circumstances, or on the eve of insolvency, voluntarily, or thru force, gives a confession of judgment that has the effect of defeating or defrauding his creditors, or of giving one or more a preference over others, the judgment is void and cannot be executed. So also a sale on credit to a person who knows of the vendor's insolvency is generally held as fraudulent as against creditors, in that it hinders and delays them. A chattel mortgage to secure a creditor, or in settlement of a debt previously contracted, or to secure a surety, if given within sixty days of an assignment, is void as toward other creditors. In Ontario by an amendment passed in 1910, if an assignment is made within sixty days after a transaction that has the effect of giving one creditor a preference over others, such transaction is presumed to be performed with that intent.

29. *Fraud by insolvent traders.*—It is not deemed fraud, legally speaking, for an insolvent trader to continue to purchase goods without disclosing his true

position, where no questions are asked. If questioned, he must either state the facts or refuse the information, leaving the other party free to accept the order or reject it. But if he represents that he is solvent when he is not, in order to get goods on credit, his act is fraudulent. If the seller discovers the true facts he may refuse delivery or stop the goods in transit. He may also have the dealer arrested for giving false replies.

The effect of these statutes in their leniency is certainly to discourage a trader who is deeply involved from continuing in business, as he may manage to pull out safely. He is not bound to publish his financial difficulties to the world.

30. *Winding up of companies.*—In an earlier section it was said that in Canada there is no Dominion bankruptcy or insolvency act. This statement must now be qualified in this respect, that there is a Dominion Winding-Up Act, applicable to incorporated companies. The Dominion Winding-Up Act applies to all trading companies, wherever incorporated, doing business in Canada, which are insolvent. Provincial Winding-Up Acts apply only to companies, not insolvent, which are in voluntary liquidation. The courts are entitled to protect the rights of Canadian creditors upon the assets of a foreign company doing business in Canada. Thus, suppose a company incorporated and having its head office in France has a branch in Montreal. If winding up proceedings are begun against the company in France, the courts

may, under the Dominion Act, order it to be wound up so far as concerns its assets in Canada. If the courts, on the other hand, order the winding-up of the Canadian end of the business, the company's operations in the foreign country of its origin are not affected unless its home creditors take similar steps.

31. *Insolvency of a company: law determined.*—A company is deemed insolvent under the Winding-up Act:

(a) If it is unable to pay its debts as they become due.
(b) If it calls a meeting of its creditors for the purpose of compounding with them.
(c) If it exhibits a statement showing its inability to pay its debts.
(d) If it has otherwise acknowledged its insolvency.
(e) If it assigns, removes or disposes of its property with intent to defraud, defeat or delay creditors, or if it attempts so to do.
(f) If, with such intent, it has procured its money, goods, land or property to be seized under execution.
(g) If it has made a general conveyance or assignment of its property for the benefit of creditors, or if without their knowledge and against their interests it sells or conveys the whole or the main part of its assets.
(h) If it permits any execution issued against it

to remain unsatisfied for fifteen days, or to within four days of the date of sale.

A company is deemed to be unable to pay its debts as they become due, and to be insolvent, when a creditor in a sum exceeding two hundred dollars has made legal demand for payment, and the company has, for ninety days in the case of a bank, and for sixty days in all other cases, neglected to pay or secure or compound for the sum claimed.

32. *Duties of liquidator.*—A winding-up order is granted upon a petition to that effect. Upon the petition being granted a provisional liquidator is appointed who takes possession of the company's assets and affairs temporarily. A meeting of creditors, shareholders and contributories is then called and a permanent liquidator appointed. This officer makes an inventory of the company's assets and a list of contributories (that is, of shareholders whose stock is not fully paid), and proceeds to collect all debts due the company. He may be authorized to continue the business temporarily. When he has liquidated the assets, he prepares a dividend sheet of which he mails a copy to all interested persons. If the dividend sheet is not contested within a prescribed time he pays any dividend and obtains his discharge from the court.

33. *All claims may be proved.*—All debts payable on a contingency, and all claims against the company, present or future, may be proved. A claim for an uncertain amount will be given a fixed value by the

court. The holder of a bill of exchange may prove both for the amount thereof and for protest charges. Damages for breach of contract may be proved. Claims are proved by affidavit of the creditor or of someone acting for him.

34. *Bulk sales.*—In several of the provinces there exist Bulk Sales Acts. The general effect of these is that it is made the duty of every person who purchases a stock of goods in bulk and thus out of the usual course of business of the vendor, before making settlement by cash, note or check, to demand and receive from the seller a statutory declaration giving the names and addresses of his creditors and the amounts he owes. The purchaser is then to retain sufficient of the purchase price to pay these debts. If this is not done and the creditors are not paid, the whole transaction is deemed fraudulent and void, as respects any creditor who is prejudiced as a result.

REVIEW

What is the derivation of the word "bankrupt"?

What difference do you note between insolvency and bankruptcy?

Who may not become voluntary bankrupts?

What do you understand by acts of bankruptcy?

What is the difference between a referee and a trustee in bankruptcy?

Under what circumstances would you feel justified in filing a voluntary petition in bankruptcy?

CHAPTER XVIII

THE RÔLE OF THE CREDIT DEPARTMENT IN DEVELOPING BUSINESS

1. *Relation of collection to sales department.*—It is just as foolish to take unnecessary risks in selling goods as it is to take unnecessary risks in buying or manufacturing. But the means taken to minimize the selling risks thru the medium of the credit man and his department are susceptible of a much broader application than has been the practice in the past. The credit man can do a great deal more for the upbuilding of a business than simply to act as a police force to discourage the wrongful appropriation of the company's products.

Among sales managers generally there is perhaps too slight a realization of the important part in general sales policy and strategy which credit and collection methods are capable of playing. Since no sale is complete until the money is collected and in the bank, it follows that the whole credit and collection policy of a business is basically a sales policy. Up to the present time it has been an unwritten law that a salesman must not set foot in the credit department; that the functions of the credit man and the seller of merchandise were as far apart as the poles, and tha'

the latter might justly regard the credit department with an unfriendly eye. To the salesman the customer was the man who gave him liberal orders and when any of these were declined or even held up for investigation, he felt that the credit manager was a narrow minded individual who cared nothing for the fact that he might be disturbing friendly relations with customers and was never so happy as when depriving the salesman of credit for a sale. Happily this attitude of mutual dislike and distrust is disappearing before a growing realization by both salesmen and credit men that each is indispensable to any real success to be attained by the other.

2. *Every salesman an assistant credit man.*—In a well coordinated organization, looking after credit is not to be considered as a side issue with the salesman, since it is part of his selling. A bill of goods which is not paid for is of no use to the salesman. Why, therefore, solicit orders which are likely to have this result?

Since in any business a large proportion of the sales comes thru the men in the field and the profits are derived thru a rapid turnover, it is the function of both sales and credit departments to quicken this turnover by insuring that credit sales are soon translated into cash.

As selling goods to poor credit risks means a waste of time, the credit man's first duty is to work constructively with the salesmen of the house to make them realize the fact. Too many credit men think

they have nothing to do except to prevent losses after orders are booked by turning down in cold blood those which appear to be questionable without any attempt to show the salesmen the reasons for doing so and thus prompting them to exercise greater care in the future.

Just as the salesman must deal with prospects man to man, a credit man to get the best results must likewise deal man to man with the debtor. The credit man cannot meet each one personally but he can know all that he should know about them if he trains the house salesmen to judge risks and to act as if they were really his assistants at the time the order is taken.

If the credit manager is to help train salesmen to become really useful as credit scouts and do the work of assistants on the credit staff as well as on the sales, he must be well informed regarding all selling plans and policies and work in close harmony with them.

No sales or advertising campaign should be launched that the credit man has not helped in his way to plan. With such relations established there will be no division of interest between the sales and credit departments. Salesmen will soon realize that knowing the customer's financial affairs intimately is as much a part of their business as knowing what the customers want to buy. Under such conditions of joint responsibility selling expenses, as well as credit losses decrease, and sales and profits increase. Lost

motion is eliminated when everybody gets around to the same viewpoint.

3. *Credit man as a salesman.*—This harmonizing of the sales and credit viewpoint, however, is not to be accomplished by words alone. Salesmen will judge from the credit man's actions as well. The latter must know the salesmen intimately and keep them in close touch with everything he is doing which will affect their customers. Salesmen should receive reports concerning them and their accounts. If there is a dispute or threat of trouble it should be referred to the salesman in the territory to get the facts rather than write the customer directly, because the salesman has an intimate personal knowledge of the situation and the credit man has not. Orders should not be turned down without first finding out what the salesman has to say about the debtor. If his report does not correspond with that of the local agencies or the attorney then an effort should be made to find out who is right.

Where new territory is being opened it is particularly necessary for credit and sales departments to work in close harmony. It is sometimes possible for the credit man, thru the machinery of his department for gathering information, to prepare the way in advance for the salesmen thru a combing of all prospects listed in the territory, and by securing advance credit reports on them in order to guide the sales efforts most effectively.

4. *The nerve center of the business.*—The credit department, judged in the light of its position to help all other departments of the business and the customers with whom it deals, can be of great service both to customers and the house. Situated as it is in relation to all other functions of the business, the credit desk is the natural place for customers to come with complaints, requests for adjustments, allowances and hard-luck stories generally. Any serious shortcomings of which the house has been guilty in the way of service rendered, deliveries, shortages, defective quality, and the like on which a debtor may hang an excuse for postponing or refusing payment, are naturally brought to the credit manager for relief.

Being given this first-hand knowledge of other people's troubles, what more natural than that the credit man should act as peace-maker. In the process of smoothing over, explaining and making amends for the faults committed by members of the house, he should be the one to initiate constructive measures to help the customer get out of troubles that are due to the fault of no one but the customer himself. The modern credit man is willing to assume this difficult rôle, because it pays to do so. The alternative to a debtor's bankruptcy and the probable loss of money due the house makes it necessary that the credit man be prepared to get on the ground, analyze the customer's troubles and, out of a real fund of tested merchandising experience, help him to get back on his feet once more.

5. *The credit man as a service man.*—After analyzing the most troublesome accounts it is usually found that lack of real business knowledge and experience is the most frequent cause of failure to pay. The customer does not lack good intentions but he either does not know the cause of his own weakness or he does not realize it strongly enough to reform his ways. Often a timely suggestion, if it comes from the man who checks his orders for shipment and at a time when the customer is asking some favor, will do more to work a reform than anything that cold-blooded pressure could ever accomplish.

Sometimes the suggestion will take the form of needed education in the principles of credit. Perhaps it is an accounting system that is needed to show the customer where he really stands. Again it may be the need for more conservative buying or better collection methods. It is not an uncommon practice for the credit man to have a representative, some one experienced in analyzing the conditions which surround a sick business, who can be sent personally to pull a merchant out of a hole. It stands to reason that if this is accomplished the merchant in question is not likely soon to forget the service rendered. It is not necessary, however, to wait until a favorable time to offer help comes. There is literally no end to the constructive suggestions that may come from the credit man before delinquency has had time to develop. They may be offered in the form of dealer help literature of all kinds. As a matter of fact,

many concerns of national importance are working in just this way.

6. *Viewing the house advertising from the credit angle.*—It is not uncommon among business houses who are accustomed to advertise vigorously to vote that campaigns be launched in which the copy seems to invite over-buying. Extravagance in language, over-emphasis on bargain savings or seeming lavishness in the offer of goods to any one on credit may have the effect of bringing many new buyers to the house, but may also result in attracting many who are obviously weak financially, and in every way unsafe to do business with. The advertising policy which fails to take the credit point of view into account is only storing up trouble and inevitable losses, to say nothing of wasted effort on the part of the credit organization to redeem what it can from the business taken under such conditions.

7. *Bringing dead accounts to life.*—While it might be assumed that the task of keeping up a concern's good name and its reputation for quality goods and service is one that naturally falls to the sales or advertising departments, there is nevertheless a distinct credit angle on this work also. Every account on the company's books which is shown to be active is proof of continued satisfaction with goods and service. The fewer cases of dispute or dissatisfaction over service or goods sold the less friction there must naturally be to retard the business growth. It is not the cases of known dissatisfaction, however, that

should interest the credit man most. What he should be more concerned about are the cases of which he knows nothing because the customer has simply quit buying and said nothing. Perhaps one of the most fruitful fields for him to cultivate for the general good of the business is the files of customers who have ceased to patronize the house.

With facilities at hand he is in a position to secure information as to causes and conditions which give him the importance of a real first aid to the upbuilding of the business. In retail lines it is quite common to circularize the names on dormant account lists with the idea of recalling to those who once patronized the store, the convenience and advantage of doing so again. The same idea is carried out in the relation of the wholesaler or manufacturer with his customers.

8. *Need for a broad credit policy.*—The credit man has a real personal interest in seeing the buyer thrive. He knows full well that the percentage of credit loss in his department is, roughly speaking, the symbol of his efficiency, just as a sales manager knows that, roughly, the volume of sales is his badge. Which of the two then has the dealer's solvency most at heart?

The credit man knows that an abnormal number of insolvent customers means his dismissal. He also knows that the moment he tries to "play safe" and pass credit only on gilt-edge risks, that same moment the inside and outside sales force will insist on a change of policy or a new credit head—and be backed up in the demand by the board of directors. The

sales department has no such narrow bounds. In any ordinary business, the greater the amount of orders turned in from all sources, except those which are manifestly fraudulent, the better pleased will the directors be. It therefore follows that the credit man is apt to be the only individual in the merchandising end of a business who must both keep dealers stocked and keep them solvent.

There is a mistaken notion in some circles that economy consists of doing without things. This is a human and also a business fallacy. Were it sound, machinery would be unknown and hand labor the universal rule. There is a mistaken notion in sales circles that a dealer should be sold only as much as he in turn can sell. On this principle a retailer's growth is decidedly limited. The new thought in credit management is that the buyer should be made financially sound by buying more—and of course, selling more. The buyer should make a profit as well as the manufacturer, not because the buyer will not buy unless he can see a profit, but because he should not buy unless he can make a profit.

After all, sound finance means as much to the buyer as to the seller, and when the size of the manufacturer's business necessitates the hiring of brains specializing in finance and credits, the by-products of those brains should be sales factors. The technique of credit has improved wonderfully in a decade. The steps toward the abolition of abuses of credit have gone steadily onward. Few, however, have made

more than a start toward the broader policy which capitalizes credit as a sales-builder.

REVIEW

What should be the attitude of the sales department to the credit department?

In what sense is the salesman an assistant credit man?

How does the credit man become a service man to the house and to its customers?

Describe the relation, if any, of credit work to advertising.

How may the credit department create good-will for the business?

INDEX

Acceptance Drafts, Use of, 237
Acceptance, Trade,
See **Trade Acceptance**
Accounts, Assigned,
See **Assigned Accounts**
Adjustment Bureaus, 278
Use of, 279; National Credit Men's Association and, 278–280
Advertising,
In determination of credit risk, 70
Age, as a factor in determining credit risk, 71
Appeals, Collection,
See **Collection appeals**
Assigned Accounts,
Methods of assigning accounts, 25; Registration of, 26
Attachment, Use of, 288
Attorney,
Effectiveness of handling a claim thru, 257; Greater number of claims turned over to, settled without suit, 258; Using attorneys in other cities, 260; Bonding notice of, 261; Cooperation with, 270
Authority, of the Credit Man, 167–68

Bad Pay Debtors, 203
Bank,
Trade acceptance and, 47; Preferential rate of discount with the Federal Reserve of the trade acceptance, 48; As sources of credit information, 122
Bankruptcy,
Meaning of, 292; Meaning of insolvency, 292; Bankruptcy and insolvency laws, 293; State and Federal laws of, 294; Two kinds of, 294; Petition of, 294; Contents of petition, 295; Acts of, 295; Five acts of, 296; Provisional remedies pending adjudication, 297; Trial and reference of proceedings to referee, 298; Meetings of creditors, 299; Trustees in, 299; Duties of bankrupt, 300; Schedules, 300; Claims in, 301–04; Valid claims, 301; Provable claims, 302; Allowable claims, 303; Voidable preferences, 304; Priority of debts in distribution of bankrupt's estate, 305; Dividends in, 305; Composition with creditors, 306; Discharge of, 307; Debts not discharged in, 307; Advantages of Bankruptcy Act, 308; Canadian practice, 309; Fraudulent conveyances and transfers, in Canada, 310; Fraud by insolvent traders, in Canada, 311; Winding up of companies in Canada, 312; Insolvency of a company, in Canada; law determined, 313; Duties of a liquidator, 314; All claims may be proved, 314; Bulk sales, 315
Bankruptcy Act,
Voidable preferences in, 304; Advantages of, 308
See also **Bankruptcy**
Black Lists, 252
Bonding Notice, 261
Book Accounts,
See **Open Book Accounts**
Book Credit,
Development of, 14; Trade acceptance and, 14; Nature of, 15; Open book account — economic objections to, 16; Open book account — ethical objections to, 19; Taking unearned discounts, 21; Charging interest on deferred payments, 22; Realizing upon open book accounts, 23; Methods of assigning accounts, 25; Registration of assigned accounts, 26; Where book accounts are advantageous, 26
Bradstreet's Mercantile Agency,
Service of, 104; Rating book of, 108; Distribution of credit information by, 108; Cost of service, 110
Bulk Sales Act, 315
Bulk Sales Law, 287
Bureau of Business Research of Harvard University, 83
Business,
Growth of credit in, 1; Credit as a phase of business management,

Business—continued
3; Value of credit for purposes of, extension of, 4–6; Aid of credit to retailer, 4–6; Danger of excessive credit to, 5; Aid of credit to manufacturer, 6; Turns of the business cycle, 10; Place of credit man in, 12; Promissory note in, 32–36; Drafts in, 36; Importance of methods of, and the granting of credit, 80–96; Turnover, 82; Study of business types, 86; Credit terms in the grocery business, 87; Credit terms in the hardware business, 89; In the boot and shoe business, 91; Credit in the lumber business, 94; Credit in the furniture business, 95; Types of financial statements in, 151; Place of the credit man in, 165; Credit man as a force in, 176; Development of, by credit, 316–25

Business Ability, in the granting of credit, 64

Business Cycle, Turns of, 10

Business, Developing thru Credit,
See **Credit Develops Business**

Business Management,
Business as a phase of, 3

Buying Methods,
Should be governed by annual sales, 5; Overbuying, 6; Danger of overbuying and the credit man, 20; Of the retailer, 66; Carnegie Steel Company's credit policies in, 67; Of the manufacturer, 68; Overbuying leads to over-equipment, 69

Business Service Department, 178
Of a New York varnish house, 178; Value of cooperation with customer, 179; H. C. Workmaster on, 180

Canada, Bankruptcy in,
Canadian practice, 309; Fraudulent conveyances and transfers, 310; Fraud by insolvent traders, 311; Winding up of companies, 312; Dominion Winding-Up Act, 312; Insolvency of a company: law determined, 313; Duties of liquidator, 314; All claims may be proved, 314; Bulk sales, 315

Capital,
Increasing the working power of, by credit, 4; Tying up, 5; In the determination of credit, 8; Tied up thru large ratio asked by

Capital—continued
banks for a loan, 17; Trade acceptance as, 41; How acquired, 77; Rating of, in Dun's and Bradstreet's rating book, 108; Credit man and, 175

Carnegie Steel Company, 67

Cash Discount
Use of, to displace acceptances, 15; As an aid to the big dealer, 19; Taking unearned, 21; Preserving, if trade acceptance is put into use, 51; Example of trade discount taking care of the, 52

Character, in Credit,
Moral character, 60; Good moral risk, 61; Only consideration in credit risk, 62

Check Laws, Utilizing the, for bad checks, 255

Claims of Creditors, in bankruptcy,
Valid, 301; Provable, 302; Allowable, 303

Collection Agency,
Effectiveness of handling a claim thru, 257; Use of, 268; Sometimes organized as an adjunct of attorney's office, 268; National Association of Credit Men's files on, 268; Work of, 269; Cooperation with, 270

Collection Appeals, 223
Personality back of, 223; Repetition in, 225; Use of habit in, 228; Appeals to the emotion, 229

Collection Department
Relation of credit department to, 212; Organization of, 215
See **Collection of money due; Collection Management**

Collection Manager, Work of,
Personal characteristics, 209; Relations of collection to credit department, 212; Making use of credit office machinery to assure collection results, 214; Organization of collection department, 215; Responsibility, 216; Training for the work — special and general, 217

Collection of Money Due,
Determining the collection policy, 194; Putting the policy to work, 195; Need for a general house policy on collections, 196; Making collections "constructive," 197; Building good-will thru collection methods, 197; What is to be learned from complaints, 199; Classification of debtors,

Collection of Money Due—continued
200; Good pay, 201; Slow pay or on "probation," 202; Delinquent or bad pays, 203; Execution proof, 203; Planning the system to carry out the policy, 205; Effect of trade usage on collection policy, 207
See **Collection Principles**
Collection — on a Friendly Basis,
Advantage and obligation, 232; Need for getting at the causes of non-payment, 232; Stages in collection procedure, 233; Notification stage, 233; Reminder stage, 234; Offer of concession, 235; Discounting notes, 235; Reproach stage, 236; Acceptance drafts, 237; Sight drafts, 238; Follow-up drafts, 238; Telephone calls, 239; Registered letters, 240; Telegram, 241; Discussion stage, 242; Defective remittances, 243; Writing to the debtor's business acquaintances, 244; Tracing moved debtors, 245; Tracing thru National Association of Credit Men, 246; Tracing thru the post office, 247; Reselling stage, 248
Collection Policy, Determination of, 194
See **Collection of Money Due**
Collection Principles,
The debtor's motives, 220; The right mental attitude, 222; The personality back of the appeal, 223; Value of repetition, 225; Need for salesmanship in collecting, 227; Utilizing the power of habit, 228; Apeals to the emotions, 229; Knowledge of the debtor essential, 230
See **Collection of Money Due; Collection—on a Friendly Basis; Collection, Unfriendly Stages of**
Collection Procedure, Stages in,
Friendly stages, 233–50; Notification stage, 233; Reminder stage, 234; Offer of concession, 235; Discounting notes, 235; Reproach stage, 236; Acceptance drafts, 237; Sight drafts, 238; Telephone calls, 239; Registered letters, 240; Telegrams, 241; Discussion stage, 242; Defective remittances, 243; Writing to the debtor's business acquaintances, 244; Reselling stage, 248; Unfriendly stages, 251–71; Final
Collection Procedure, Stages in—cont'd
stages, 252; black lists, 252; Offering debtors' accounts for sale, 253; House collection agency, 253; Final notice before suit, 255; Utilizing the bad check law, 255; Selecting an attorney, 257; Using attorneys in other cities, 260; Bonding Notice, 261; Using a third party to "forward" claims, 265; Using collection agencies, 268–271
Collection System,
Relations to credit department, 212; Preparations for, 213; Need for salesmanship in 227
See **Collection of Money Due**
Collection, Unfriendly Stages of,
Advisability of going to last extreme in collecting, 251; Final stages of collection procedure, 252; Black lists, 252; Offering debtors' accounts for sale, 253; House collection agency, 253; Final notice before suit, 255; Utilizing the bad check laws, 255; Selecting an attorney, 257; Using attorneys in other cities, 260; Using a third party to "forward" claims, 265; Using collection agencies, 268; How the agency works, 269; Cooperating with the attorney or agency, 270
Commercial Agency Report, 159
Example of, 159; Analysis of, 160
Commercial Transaction,
What is, 49; Advertising space as, 50
Complaints,
What is learned from, 19?
Contract Sales, 28
Cooperation,
Value of, with customer, 179
Cooperative Methods, in Credit Investigation,
See **Credit Investigation, Cooperative Methods in**
Credit,
Growth of, in modern business, 1; Meaning of, 2; General and individual aspects of, 2; Services of, 4; Danger of excessive, 5; Main points to determine, 8; An exchange of goods or service, for a promise to pay in the future, 8; Methods of granting, 9; Book credit, 14–30; Documentary credit, 31–57; Limitation of, 58; Personal, 58; Two characteristics of credit transactions, 59; Moral

Credit—continued
character in relation to granting of, 60; The good moral risk in, 61; Mercantile, 63; Lines of reasoning upon which credit is granted, 64; Granting of, 80–96; Turnover and, 81–85; Duration of, 85; Terms of, in grocery business, 87; Terms of, in hardware business, 89; Terms of, in boot and shoe business, 91; Terms of, in men's and boys' suits, 93; Terms of, in lumber business, 94; Terms of, in furniture business, 95; Sources of credit information, 125–144; Necessity for credit man to understand, 176; Essentials of organization in department, 182; Discrimination in the granting of, 187

Credit Book,
See Book Credit

Credit Clearing,
Plan of, 131; Defects of, 132; Credit Clearing House, 134; Giving credit advice by Credit Clearing House, 136

Credit Clearing House, 134
Work, 134; Report of, 134, 135; Giving credit advice, 136; Membership, 136; Basis of system, 137

Credit Department,
Essentials of organization, 182; Functions of, 183; Test of a good credit office system, 182; Handling of new order in, 186–191; Standardizing the routine of, 192; Relation of collection partment to, 212–17
See Credit Management

Credit Develops Business,
Relation of collection to sales department, 316; Every salesman an assistant credit man, 317; Credit man as a salesman, 319; The nerve center of the business, 320; Credit man as a service man, 321; Viewing the house advertising from the credit angle, 322; Bringing dead accounts to life, 322; Need for a broad credit policy, 323

Credit, Documentary,
See Documentary Credit

Credit — Granting, Discrimination in, 187

Credit, Granting of — Business Considerations
Importance of business methods, 80; How credit is affected, 81; Differences in turnover, 82; Amount of credit affected by turnover, 84; Duration of credit, 85; A study of business types, 86; Customary credit terms in the grocery business, 87; Customary credit terms in the hardware business, 89; Customary credit practice in the boot and shoe business, 91; Men's and boys' suits, 93; Customary credit terms in the lumber business, 94; Customary credit terms in the furniture business, 95

Credit, Granting of — Personal Considerations,
What limits credit, 58; Personal credit, 58; Deciding when to grant personal credit, 59; Moral character in its relation to credit, 60; The good moral risk, 61; Mercantile credit, 63; Business ability, native and acquired, 64; Technical ability, 65; Knowledge and experience, 66; Buying methods, 66; Judgment, 68; Equipment, 69; Advertising, 70; Location, 70; Age, 71; Evidence of financial ability, 72; Outside ventures, 74; Distribution of due dates, 74; Cooperation with mercantile agencies, 75; Insurance, 75; Payment methods, 76; Financial strength, 76; Capital — how acquired, 77; The customer who makes unjust claims, 78

Credit Information, Analysis of,
The financial statement; merchandise on hand, 145; Notes and accounts, 146; Cash on hand or in bank, 147; Fixtures, machinery, etc., 148; Owing for merchandise on open account, 148; Owing to banks and to relatives, 148; Outside assets, 148; Convertibility of assets, 149; Can more definite rules be given, 151; Business types, 151; Typical statements, 152; Varying considerations, 153; The effect on credit information, 154; Analysis of agency reports, 154; Report on a manufacturing firm, 155; Analysis, 156; Advance report and salesmen's data, 158; Analysis of commercial agency report, 160

Credit Information, Sources of
Importance of complete information,

Credit Information, Sources of—cont'd 97; Over-estimating the value of references, 98; Five important sources of credit information, 98; Property statement, 99; Growing importance of the property, 100; Periodical revision of signed statements, 101; Common forms of property statements, 103; Mercantile Agency Service, 104; Dun's and Bradstreet's rating books, 108; Special credit reports, 109; Cost of the agency service, 110; Special trade agencies, 110; Salesman as a credit reporter, 111; Traveling credit man, 114; Local attorney as credit reporter, 116; Law lists and free attorney reports, 118; Banks as sources of credit information, 122

Credit Insurance,
Use of, 274–76; Arguments in favor of, 276; Arguments against, 277

Credit Investigation, Cooperative Methods in,
Credit cooperative methods, 125; characteristics of ledger experience, 126; Procedure in the exchange of ledger information, 128; Reciprocity a necessary element, 129; Operating thru a central bureau, 129; Credit clearing, 131; Inherent defects of credit clearing, 132; The credit clearing house, 134; The percentage system, 134; Giving credit advice, 136; A system based on abnormal transactions, 137; Growing recognition of credit interchange, 138; A probable credit interchange system of the future, 139; The national association of credit men, 141; Association ethics, 143; Retail credit men's national association, 144

Credit Man, The,
Problem of, 11–13; Place of, in business, 12–13; Traveling, 114; Credit man's place in the scheme of business, 165; The question of authority, 167; Attitude toward the customer, 168; Mental qualities desirable in a credit man, 170; Moral and social qualities, 172; Special training, 173; The credit man as a business force, 176; A "business service" department, 178; Direct value of

Credit Man, The—continued
cooperation with customer, 179; Work of, 184; As a salesman, 319; As a service man, 320
See **Credit Management, Collection Manager**

Credit Management,
Essentials of organization, 182; Functions of the department, 183; Requesting a signed statement, 185; Handling new orders, 186; Discrimination in credit-granting, 187; Understanding as to terms, 188; Holding the order pending investigation, 189; Final disposition of the order, 190; Departmental organization problems, 191; Standardizing the departmental routine, 192; Departmental reports, 192

Credit, Mercantile,
Growth of credit in modern business, 1; Meaning of credit, 2; General and individual aspects of credit, 2; Increasing the working power of capital, 4; Excessive credit a danger, 5; How credit helps to manufacturer, 6; Main points to determine credit, 8; Methods of granting credit, 9; Credit affected by general trade conditions, 10; Turns of the business cycle, 10; Place of the credit man in the business, 12; Basis of, 63; System developed slowly, 63; Mercantile credit system, 63; Modern system complementary to commercial system, 64

Creditors, in Bankruptcy,
Meeting of, 297; Composition with, 306
See **Bankruptcy**

Credit, Personal,
See **Personal Credit**

Credit Protection,
Methods of securing, 273; Credit insurance, 274; Arguments in favor of credit insurance, 276; Arguments against credit insurance, 277; Adjustment bureaus, 278; Means of recovery of goods, 280; Unpaid seller's lien, 280; Stoppage in transitu, 281; Reselling the goods, 282; Recovery on the ground of fraud, 283; Steps in litigation, 283; Importance of evidence, 284; Enforcing the judgment, 285; Exemptions, 285; Supplementary proceedings, 286; Setting aside fraudulent con-

Credit Protection—continued
veyances, 286; Bulk Sales Law, 287; Receivers, 287; Garnishment, 288; Attachment, 288; Imprisonment for debt, 289; Criminal law as a remedy, 290; Shall we go to law?, 291
Credit Risk — Factors that Determine,
Moral character. 60; Business ability, 64; Technical ability, 65; Knowledge and experience, 66; Buying methods, 66; Judgment, 68; Equipment, 69; Advertising, 70; Location, 70; Age, 71; Evidence of financial ability, 72; Outside ventures, 74; Distribution of due dates, 74; Importance of business methods, 80; Three C's in, 154; Analysis of, 154–158
Credit System,
Organization of 182: Test of a good, 184; Four files required in, 191
See **Credit Management**
Credit Terms in Retail Stores,
See **Retail Stores, Credit Terms in**
Customer,
Attitude of credit man toward, 168; Value of cooperation with, 179; Handling new, 186; Aids to, in payment of bills, 195; Classification of debtors, 200–205

Debtors,
Classification of, 200; Good pay, 201; Slow pay, 202; Delinquent or bad pay, 203; Execution proof, 203; Motives of, 220; Attitude to be taken toward, 222; Collection follow-up, on friendly basis, 233–50; Tracing moved, 245; Tracing debtors thru National Association of Credit Men, 246; Tracing debtors thru the post office, 247
Deferred Payments, charging interest on, 22
Discount, Cash,
See **Cash Discount**
Documentary Credit,
Forms of, 31; Promissory note, 32; Indorsement, 34; Tangible evidence of indebtedness, 35; Action on notes, 36; Drafts, 36; Notes, drafts and acceptances, 37; Nature and form of the trade acceptance, 38; Summary of advantages to the seller, 41–4; Advantages to the buyer. 44–7; Trade acceptance and the bank,
Documentary Credit—continued
47; What is a commercial transaction, 49; Preserving the discount, 51; Other trade acceptance features, 52; Handling accounts when acceptance is not paid, 53; Retailers and the trade acceptance, 54; Introducing the trade acceptance, 55; future of trade acceptance, 57
Dominion Winding-Up Act, 312–14
Draft,
Made by the person to whom the money is owing, 36; Order on the debtor, 36; Use of in foreign trade, 37; Acceptance drafts in collection follow-up, 237; Sight drafts, a request for money due, 238; Follow-up drafts, 238
Due Dates, Distribution of, determines credit, 74
Dun's Mercantile Agency,
Service of, 104; Organization of, 107; Rating book of, 108; Distribution of credit information by, 108; Capital rating of, 108; Credit rating of, 108; Cost of service, 110; Report on a manufacturing firm, 155; Report of, on commercial failures, 177
Duration of Credit, 85

Equipment, and buying methods, 69
Execution Proof Debtors, 203
Experience, in the granting of credit, 66

Factors Determining Credit Risk,
See **Credit Risk—Factors that Determine**
Failure,
Annual sales should govern buying, 5; Misuse of credit, 6; Assigning accounts, 25; Technical ability prevents, 65; R. G. Dun and Co. on — 80 per cent due to faults of failing merchants, 177
Federal Reserve Bank,
Preferential rate given trade acceptances in, 48
Financial Ability, determines credit, 72–77
Financial Statement, Analysis of,
Merchandise on hand, 145; Cash value of merchandise, 145; Notes and accounts, consideration of, in, 146; Consideration of cash on hand or in bank, in, 147; Fixtures, machinery, etc., in, 148; Owing for merchandise on open

Financial Statement—continued
account, 148; Owing to banks and to relatives, 248; Outside assets, 148; Convertibility of assets, 149; Business types, 151; Typical statements, 152; Varying considerations in, 153; Effect on credit information of Alexander Wall's scheme, 151–54; Requesting a signed statement, 185
Follow-up, Collection, Stages in,
See **Collection Procedure, Stages in**
Follow-up Drafts, Use of, 238
Fraud, Recovery of Goods on the Ground of, 283
Free Reports, 118
Use of, 119; Abuse of, 119; Form of, 120
Friendly Collections,
See **Collection—on a Friendly Basis**
Furniture Business,
Customary credit terms in, 95; Grouped around half a dozen centers, 95; Exhibitions in, 95

Garnishment, 288
Grounds for, 289; Regarded as extreme remedy, 289
Good Pay Debtors, 201
Good-will, Building up of, thru Collection methods, 197
Granting of Credit — Business Considerations,
See **Credit, Granting of—Business Considerations**
Granting of Credit — Personal Considerations
See **Credit, Granting of—Personal Considerations**
Grocery Business,
Customary terms of credit in, 87, Foreigners run, 87; Abuse of credit terms in, 88; Three classes of goods sold, 88; Wholesale grocers do not insist upon strict observance of credit terms, 89

"Hard Times," Credit during, 11
Hardware Business,
Customary terms of credit in, 89; Builders' hardware, 90; Shelf hardware, 90
Harvard University, Bureau of Business Research of, 83

Imprisonment for Debt, 289
Seldom resorted to, 289, Criminal law as a remedy for collecting debts, 289
Indebtedness,
Promissory note as tangible evidence of, 35
Indorsement of Promissory Note, value of, 34
Insolvency,
Meaning of, 292; Two definitions of, in law, 292–93; Laws of, 293; Distinction between bankruptcy laws and, 294; State and Federal laws of, 294
See **Bankruptcy**
Insurance,
Value of knowledge of, to the credit man, 175; Credit, 274; Credit insurance gives the business man control of his costs, 276; Arguments against credit insurance, 277

Judgment, Value of, 68

Knowledge, in the granting of credit, 66

Law,
Value of knowledge of, to the credit man, 175
Lawsuits
See **Litigation, Steps in**
Ledger Information,
As credit cooperative method, 125; Characteristics of, 126; Value of, 126; Form of, 127; Procedure in exchange of ledger information, 128; Reciprocity a necessary element of, 129; Operating thru a central bureau, 129; Clearing, 131
See also **Mercantile Agencies**
Law Lists,
Fee for, 118; Use of, 118
Liquidator, Duties of, 314
Litigation, Steps in,
Debtor's status as creditor must be established, 282; Importance of evidence, 284; Enforcing the judgment, 285; Exemptions, 285; Supplementary proceedings, 286; Setting aside fraudulent conveyances, 286; Bulk Sales Law, 287; Receivers, 287; Garnishment, 288; Attachment, 288; Imprisonment for debt, 289; Criminal law as a remedy, 290; Shall we go to law, 291

Local Attorney as Credit Reporter, 116
Attorney's blank, 117; Free attorney reports, 118
Lumber Business,
Customary credit terms in, 94; National Wholesale Lumber Dealers' Association, 94

Management, Credit,
See **Credit Management**
Manufacturer,
Value of credit to, 6; Buying ability of, 68; Judgment of, 68
Maryatt, Mr., on lawsuits, 291
Men's and Boys' Suits,
Credit terms in selling, 93; Season's dating in the selling of, 93
Mercantile Agencies,
Services, 104; Dun's and Bradstreet's, 104; Organization of, 107; Dun's and Bradstreet's rating books, 108; Special credit reports of, 109; Cost of service, 110; Special trade agencies, 110; Iron and Steel Board of Trade, 111; National Jeweler's Board of Trade, 111; Furniture Commercial Agency Company, 111; Leather Mercantile Agency, 111; Consolidated Building Trades Association, 111; Analysis of Agency reports, 154; Report on a manufacturing firm, 155; Advance report of, 158; Commercial Agency report, 159–164
Mercantile Credit,
See **Credit, Mercantile**
Moral Character, in its relation to Credit, 60
The good moral risk, 61; Only consideration, 62

National Association of Credit Men, 141
Object of, 141; Membership of, 142; Ethics of, 143; Tracing debtors thru, 246; Files on agencies, 268; Adjustment bureaus of, 278
National Wholesale Lumber Dealers' Association, 94
"Non-Repeaters," and book accounts, 28
Notification, for debts, 233

Open Book Accounts,
Nature of, 15; Economic objections to, 16; Sales on, 17–19; Ethical objections to, 19; Realizing upon, 23; Lending upon, 23; Advantages of, 26–29; Non-repeaters and, 28; Contract sales and, 28; Repeaters and, 29
Order, New,
Handling of, 186; Holding, pending investigation, 189; Final disposition of, 190
Organization, of credit department, 182
Overbuying,
Meaning of, 6; Danger of, to credit man, 20; Carnegie Steel Company's credit policies, 67; Equipment and, 69
Percentage System, in Credit Information, 134
Personal Credit,
First credit, 58; Deciding when to grant, 59; Two characteristics of every credit transaction, 59
Petition in Bankruptcy, 294
Use of, 294; Contents of, 295
Post Office, Tracing debtors thru, 247
Preferences, Voidable, in bankruptcy, 304
Principles, Collection,
See **Collection Principles**
Promissory Note,
Written promise to pay, 32; Example of, 32; Essentials of, 32; Indorsement of, 34; Accommodation indorsement, 35; Tangible evidence of indebtedness, 35; Negotiability of, 35; Action on, 36; Use of, in domestic trade, 37
Property Statement,
Basic consideration in granting of credit, 99; Growing importance of, 100; Periodical revision of signed property statements, 101; Value of, 101–103; Common forms of, 103; Specimens of, 104–106
Prosperity, Credit during time of, 11
Protection, Credit,
See **Credit Protection**
Receivers, 287
Referee, in Bankruptcy, 298
References,
Overestimating the value of, 98; Abuse of, to obtain credit, 98
Registered Letters, Use of, in collection follow-up, 240
Reminder Stage, in collection follow up, 233
Offer of concession, 235; Discounting notes, 236
Reports, of Credit Department, 192

Reproach Stage, in collection follow-up,
Use of stamps and labels in, 236; Acceptance drafts, 237; Sight drafts, 238; Follow-up drafts, 238; Telephone calls, 239; Registered letters, 240; Telegrams, 241
Reselling Stage, in collection follow-up, 249
Reselling the Goods, 282
Right of seller, 282
Retail Credit Men's National Association, 144
Retailer,
Value of credit to, 4; Excessive credit a danger to, 5; Danger of overbuying, 6; Value of open book account to, 27; Trade acceptance on, 54; Business ability in granting of credit, 64; Technical ability of, in receiving credit, 64; Knowledge and experience of, 66; Buying methods, 66; Judgment, 68; Location of, and credit risk, 70; Effect of turnover on the granting of credit to, 81–85; Credit terms in grocery business, 87; Credit terms in hardware business, 89; Credit terms in boot and shoe business, 91; Credit terms in men's and boys' suits, 93; Credit terms in furniture business, 95; Retail Credit Men's National Association, 144
Retail Stores, Credit Terms in,
In the grocery business, 87; Abuse of credit in the grocery business, 87–88; In the hardware business, 89; In the boot and shoe business, 91; In men's and boys' suits, 93; In the lumber business, 94; In the furniture business, 95

Sales Department,
Relation of collection to, 316; Every salesman an assistant credit man, 317
Salesman,
As credit reporter, 111–14; Data on credit by, 158; New-customer report of, 162; As an assistant credit manager, 317
Shoe and Boot Business,
Customary terms of credit in, 91; Subject to seasonal influences, 91; Shipments in, 92
Sight Drafts, 238
Sloane, W. & J., and trade acceptances, 57
Slow Pay Debtors, 202
Sources, of Credit Information,
See **Credit Information, Sources of**
Specialties, 29
Stoppage in Transitu,
As a means of recovery of goods, 280–282; Meaning of, 281; Right of, open only after buyer has become insolvent, 281; Uniform Sales Act, 281
Suit, Bringing,
See **Litigation, Steps in**

Technical Ability, in the granting of credit, 65
Telegrams, Use of, in collection follow-up, 241
Telephone Calls, Use of, in collection follow-up, 239
Tennessee, Bad Check Law for, 256
Trade,
Credit affected by general conditions of, 10, Notes and drafts in, 37; Use of trade acceptance in, 38
Trade Acceptance,
Most familiar credit instrument in England, 14; Since the Civil War in America, 14; Present move for the use of, 38; Nature and form of, 38; Specimen of, 40; Advantages to the seller, 41–4; Service of, 42; Failure to meet, 43; Value of, 43; Buyers who refuse to use, 44; Advantages to the buyer, 44–7; The bank and, 47; Preferential rate of discount with the Federal Reserve bank, 48; Commercial transaction in, 49; Eligible, 50; Discount and, 51; Other features of, 52; Handling accounts when acceptances are not paid, 53; Retailers and, 54; Introducing the, 55; Sample of, sent out to trade, by wholesale house, 56; Future of, 57
Trade Usage, Effect on collection policy of, 207
Traveling Credit Man,
Necessity for, 114; Function of, 115; Services rendered to customers by, 116
Trustees in Bankruptcy, 299
Turnover,
Importance of, in determining credit risk, 81; Differences in, 82; Amount of credit affected by, 84
Type, Business, Study of, 86

Unfriendly Collections,
See **Collection, Unfriendly Stages of**

Uniform Sales Act, 281

Wall, Alexander, on Financial Statements, 151–54

Western Union Telegraph Company, 241

Workmaster, H. C., on value of co-operation with the customer, 180

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